Economics and Sociology
Occasional Paper No. 2372

COMMERCIAL BANKS IN MICROFINANCE: NEW ACTORS IN THE MICROFINANCE WORLD

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July 1997

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Abstract

Commercial banks are becoming the new actors in the world of microfinance now that repressive financial market policies have been dismantled in many developing countries. This study documents and discusses the major issues banks must confront to provide microlending services to low income clienteles. The recent experiences of eighteen banks are investigated in terms of new products and financial technologies, and organizational structure and regulation. Their institutional performance in outreach and sustainability is also highlighted from interviews with bank officers. Lessons from these experiences are summarized along with recommendations to the donor community to facilitate these new initiatives.

CHAPTER ONE: OVERVIEW

I. Introduction

This is one of the first reports written about the role of commercial banks in microfinance. The reason is simple: there has been little to tell because commercial banks have been so notably absent in this field. In their absence, microenterprise lending has developed on an alternative track through a large number of non-governmental organizations (NGOs) and other specialized financial institutions. Dedicated to improving the lot of the poor in developing countries, these microlending NGOs first entered the microenterprise field in the 1980s, responding to the critical income and employment opportunities of their urban and rural clientele. Today some leading NGOs have created financial technologies that serve increasing numbers of the poor, generate repayment rates that compare favorably to many traditional commercial banks' own loan performance, and have achieved increasing levels of sustainability, even to the point of outright profits without subsidies (Christen, Rhyne, Vogel, and McKean).

Nevertheless, the majority of NGOs have encountered serious problems of sustainability. This suggests there may be serious flaws in the NGO approach that need to be acknowledged. These appear to emerge from their organizational design; i.e., property rights and governance structures, features that are generally strengths in commercial banks. At the same time, NGOs usually are not responding to the widespread demand for deposit services from their clienteles, a demand effectively serviced by banks. Finally, it should be noted that the most successful, pathbreaking NGOs, two of which are investigated in this study, are currently transforming themselves into regulated financial intermediaries that incorporate deposit services as a growing part of their services.

A surprising number of commercial banks in developing countries are now beginning to examine the microfinance market. Stiff banking competition in many countries has forced some to diversify into new markets. Some seek a new public image. Others have heard about the profits of successful microenterprise banks in Indonesia and financial NGOs-turned-banks in other countries. Over the last five years, their exploration of this new market has been facilitated by donor-funded loan guarantees, central-bank rediscount lines, and specialized technical assistance. Although the initial funds for loans frequently came through donor intermediated sources, commercial banks in time began to draw upon their own deposit sources for a growing share of their total funds for microloans.

While traditional commercial banks and finance companies are beginning to look at ways to service the large number of potential clients for small loans, many microenterprise lending NGOs with heavy case loads have begun to scale-up operations by transforming themselves into regulated banks or specialized financial institutions offering microdeposit facilities as well as microloans. The new NGOs-turned-banks and the traditional banks are beginning to converge on a single potentially profitable market but from two sharply contrasting financial worlds.

NGO and bank operations, however, hardly begin to cover the demand for microfinancial services. NGO programs are generally minuscule in each country, and the banking sector is still by and large just initiating its entry into this market niche, although in some countries banks are already larger providers of loans to microentrepreneurs than NGOs (Almeyda, 1996).

The U.S. Agency for International Development (USAID) has been concerned with the question of how to expand services to microenterprises on a sustainable basis, and in November of 1996 it sponsored a conference with 17 regulated financial intermediaries from 16 countries. Among the participants were state-owned banks, private commercial banks, regulated finance companies and NGOs that had transformed themselves into banks. The event was a first attempt to convene bankers involved in microfinance to share their experiences, learn best practices from one another, and discuss obstacles to further expansion. This study draws principally from interviews held with these bankers. In a preliminary fashion, it documents some of this fledgling and diverse experience.

II. The Challenge of Microfinance for Commercial Banks

A. Why Bankers Have Not Offered Microfinance Services

Private, domestic commercial banking is a relatively recent phenomenon in many developing countries, especially in Africa. While limited domestic banking existed in some Asian and Latin American countries in the past century, the subsidiaries or agents of foreign banks dominated in foreign trade activity. In the 1950s through the 1970s, financial systems in many developing countries were predominantly composed of state-owned banks and of branches of foreign-owned commercial banks which provided short-term commercial and trade credit. The state-owned banks promoted economic development priorities through a network of financial institutions such as agricultural banks, development banks, and export banks, while borrowing heavily from multilateral and foreign private banks to support these efforts (World Development Report, 1989; Gonzalez-Vega and Graham, 1995). The private local banks that did exist were typically relatively small, and often served a closed set of business groups.

The regulatory repression of formal financial markets in most developing countries up to the 1980s, *i.e.* interest rate ceilings, high reserve requirements, and directed credit lines, largely precluded the potential for established banks to service a higher cost and riskier microenterprise clientele. Banks were prohibited from charging sufficiently high interest rates to cover the costs and risks of lending to this clientele. With the advent of structural adjustment processes and financial liberalization in the 1980s, private domestic commercial banking expanded rapidly. Many new private banks were founded by large business groups for the purpose of accessing funds for their own businesses and corporations. As such, they naturally favored the large accounts of an established clientele. When granting loans to less familiar clients, banks protected themselves with asset (mostly real estate) collateral two to three times the value of the loans. Although the new regulatory environment was more favorable, these new commercial bankers were unlikely providers of loans to small businesses, small farmers, and microentrepreneurs.

Competition is growing, however, as new banks enter the market under banking laws that allow more freedom of entry and a less repressed regulatory environment. For example, Honduras has 18 commercial banks for an economically active population of 1.7 million people; most of these institutions were licensed in the last decade and are still small. The struggle to survive is forcing many of these banks to look at new markets, including the microfinance market, and the deregulation of financial markets is creating an environment in which these opportunities can now be explored for the first time within the regulated financial sector.

Most bankers have not regarded microfinance as a genuine option, however, because they have believed it unprofitable. When asked why they do not pursue microfinance, traditional commercial bankers have typically expressed three basic concerns:

1) **Too Risky**: Bankers perceive small businesses and microenterprises as bad credit risks. Many insolvent state-owned agricultural banks seemed to prove that small farmer clients could not or would not repay their loans. The perception is that small clients do not have stable, viable businesses for which to borrow and from which to generate repayment. Moreover, these potential clients lack traditional collateral to guarantee their loans. Finally, banks no doubt also recognized they did not have appropriate lending technologies to serve these clienteles (i.e., correct screening mechanisms to separate good from bad credit risks).

2) **Too Expensive**: Bankers also believe that because micro loans are small and short-term, bank operations will be inefficient and costly. It takes the same amount of time and effort (if not more) to make a $1,000 loan as a $100,000 loan, but the return on the larger loan is much greater. So why make a small loan?

3) **Socio-economic and Cultural Barriers**: According to bankers, small and micro business clients have difficulty approaching the bank because they lack education and do not possess business records to demonstrate cash flow. In many developing countries, social, cultural and language barriers do not allow for an easy relationship with a modern banking institution.

It is hoped, however, that with a more widespread diffusion of innovations in financial technologies, reducing the risks and costs of microlending, more banks will begin to incorporate microentrepreneurs into their portfolios.

B. Comparative Advantages of Commercial Banks in Microfinance

At first glance, banks would appear well positioned to offer financial services to ever increasing numbers of microfinance clients and to earn a profit. Banks have several advantages over non-bank, microlending NGOs:

* they are regulated institutions fulfilling the conditions of ownership, financial disclosure, and capital adequacy that help to ensure prudent management;

* many have physical infrastructure, including a large network of branches, from which to expand and reach out to a substantial number of microfinance clients;

* they have well-established internal controls and administrative and accounting systems to keep track of a large number of transactions;

* their ownership structures of private capital tend to encourage sound governance structures, cost-effectiveness, and profitability, which leads to sustainability;

* they have their own sources of funds (deposits and equity capital); hence they do not have to depend on scarce and volatile donor resources (as do NGOs); and

* they offer loans, deposits, and other financial products that are, in principle, attractive to a microfinance clientele.

All of these advantages could give banks a special edge over microlending NGOs in providing microfinancial services.

C. Obstacles for Commercial Banks in Microfinance

Banks lack, however, some key ingredients - most of all, the financial technologies to reach a low-income population. They also face thorny internal constraints which must be overcome before they can produce a large, successful microfinance program.

Our study of banks in microfinance identified at least six key interrelated issues that banks need to resolve in order to enter the microfinance market successfully:

* **Commitment**: the commitment of commercial banks (particularly the larger banks) to microenterprise lending is often fragile, and generally dependent upon one or two visionary board members rather than based solidly in its institutional mission.

* **Organizational design**: Microfinance programs need to be inserted into the larger bank structure in such a way that they have relative independence and, at the same time, can handle thousands of small transactions efficiently.

* **Financial technology**: Banks need to acquire an appropriate financial technology to service the microenterprise sector, *i.e.* financial innovations that permit a cost-effective analysis of creditworthiness, the monitoring of a large number of relatively poor clients and the adoption of effective collateral substitutes.

* **Human resources**: Given that microfinance programs differ so radically from traditional banking, banks must recruit and retain a specialized staff to manage these

programs. Issues of recruitment, training, and performance-related incentives require special consideration.

* **Cost-effectiveness**: Microfinance programs are costly because of the small size of loans. The typically higher overhead levels of banks (well-remunerated staff, elegant buildings, information management systems) cannot be sustained by a microfinance program alone. Strategies must be found to reduce costs by rapidly expanding the scale of its microenterprises portfolio (*i.e.*, increasing the number of loans). Banks must organize microfinance operations and specialized training by covering costs through scale economies.

* **Regulation and supervision**: Banks must communicate with banking authorities to ensure that reporting and regulatory requirements take into account the specialized nature of microfinance programs.

D. Purpose of the Study

The bulk of the data for this study comes from interviews with 17 bankers attending a *Commercial Banks in Microfinance* conference held in November 1996 in Washington, D.C. Information for an additional bank (BancoSol) was incorporated from a separate study carried out by Ohio State University researchers. The three-day conference focused on four principal topics: products and services, bank structure and branch management, staffing, training, and incentives, and regulation and supervision. As the largest gathering so far of microfinance bankers, the conference presented a unique opportunity to understand better the progress and obstacles facing this field.

The purpose of this paper is three-fold:

- to briefly document the experiences with microfinance programs of these 17 banks;
- to describe some of the main issues they face; and
- given the small scale of most of these operations, to draw some conclusions concerning their future as large-scale providers of microfinancial services.

It should be made clear at the outset that, given the small sample of banks reviewed for this study, the analysis and conclusions derived are preliminary and will require future verification, as the field grows.

Chapter Two discusses some of the major obstacles that burden commercial banks as they enter the microfinance market, and it suggests that some institutional types may manage these problems better than others. Chapter Three describes the lending experiences of the 17 participating banks at the *Commercial Banks in Microfinance* conference and of BancoSol, which was invited but unable to participate. The diversity of the experiences will become apparent, as well as the fact that banks are making substantial progress in entering the market. Chapter Four draws some preliminary conclusions based on the findings and discussion in Chapters Two and Three, and it offers recommendations as to how to promote the scaling-up of commercial bank microenterprise activity and potential roles for the donor community in this endeavor.

CHAPTER TWO: ISSUES FOR COMMERCIAL BANKS IN MICROFINANCE

I. Types of Banks in Microfinance

The banks reviewed in this study differ from one another in many respects. Each operates in a different cultural and economic context, and each has a somewhat different institutional structure and mandate. In general, there were four main types of intermediaries:

1) Full-service private commercial banks. Most have a national presence and offer a host of financial products and services through an extensive branch network.

2) State-owned banks. These large banks provide multiple services according to government priorities. They often act as a channel for government transfers, payments, or receivables, and usually serve a large number of depositors.

3) Finance companies and specialized banks. These smaller financial institutions focus on a particular sector, such as housing or consumer lending and generally have a regional rather than a national presence.

4) Microlending NGOs transformed into regulated banks or specialized financial institutions. These small institutions have limited regional presence and a highly specialized program.

Because of their different origins, each of these types of institutions approaches microfinance slightly differently, and each faces somewhat different obstacles. For our analysis, we found it useful to merge the first two bank types into one group and the second two specialty institutions into another group. Both the size and degree of specialization of the bank heavily influence its approach to the microfinance market and its ability to resolve the key constraints discussed below. The 17 banks of the conference plus BancoSol can be divided into two broad categories as illustrated in Table 2.1.

Table 2.1 Roster of Banks Interviewed with Characteristic Ownership Structure and Microlending Indicators in 1996

A. Large, Multi-Service Banks		Ownership	Microlending Indicators
Banco Agrícola Comercial	El Salvador	Private bank with many shareholders	3.3% of portfolio in ML
Banco del Desarrollo	Chile	Private bank with many shareholders	100% of portfolio in ML for microenterprise subsidiary
Banco del Pacífico	Ecuador	Private bank with many shareholders	2% of portfolio in ML
Bank of Nova Scotia	Guyana	Private international bank. MF Subsidiary.	9% of portfolio in ML 100% for subsidiary
Banco Wiese	Peru	Private bank with few shareholders	10% of portfolio in ML
Bank Rakyat Indonesia	Indonesia	State-owned bank. Unit Desa program.	100% of portfolio in ML for Unit Desa program
Multi-credit Bank	Panama	Private bank with few shareholders	10% of portfolio in ML
National Development Bank	Egypt	Private bank with many shareholders	3.7% of portfolio in ML
Standard Bank	South Africa	Private bank with many shareholders	Negligible ML portfolio. Large savings program.
Worker's Bank	Jamaica	Private bank with many shareholders	New credit program. Large micro savings.
B. Small and Specialized Banks			
BancoSol	Bolivia	NGO transformation	100% of portfolio in ML
Bank Dagang Bali	Indonesia	Family-owned bank	83% of portfolio in ML
Banco Empresarial	Guatemala	Private bank with few shareholders	11% of portfolio in ML
Caja Los Andes	Bolivia	NGO transformation	100% of portfolio in ML
Centenary Bank	Uganda	Private bank with few shareholders	83% of portfolio in ML
Family Finance Building Society	Kenya	Housing finance company with few shareholders	85% of portfolio in ML
Financiera Familiar	Paraguay	Consumer lending company with few shareholders	20% of portfolio in ML
Panabo Rural Bank	Philippines	Rural bank with few shareholders	27% of portfolio in ML

Source: Interviews with bankers at November 1996 conference.

The ten large multi-service banks record asset and deposit levels many multiples greater than those of the small, specialized banks. Indeed in most cases they rank among the largest banks in their respective countries. Not surprisingly, their capital or equity base consists of many shareholders and, with the exception of the state-owned Bank Rakyat Indonesia, microlending constitutes a relatively small share of the banks total portfolio (typically below 10 percent).

In this institutional setting, microfinance will not rank high among the operational divisions within the bank, and the future of these programs will strongly depend upon the support of a few important shareholders or bank officers. Furthermore, even programs that break even and generate earnings are not necessarily secure. They still have to compete with other divisions with even higher earnings for use of the bank's scarce deposit funds. In contrast to free-standing microlending NGOs, microenterprise programs in commercial banks must meet a demanding opportunity cost criterion to continue growing with bank resources. At the same time, some banks, to protect their image, may find it difficult to charge a sufficiently high interest rate on microloans to cover their costs.

The eight small specialized banks, in contrast, have incorporated microenterprise lending as an important mission for the institution. These banks consist of former financial NGOs that are becoming banks or bank-equivalent institutions, consumer lending or housing finance companies, or private banks with a few shareholders all of whom are generally committed to microlending. Micro and small loan activity constitutes a far more important share of their total portfolios as these institutions penetrate the niche markets of microenterprise lending.

II. The Policy Environment and Six Key Obstacles Banks Face in Microfinance

This preliminary review of banks in microfinance first documents how the financial market policy environment has improved substantially in practically all the countries where the banks in this study operate. This positive development was necessary but not a sufficient condition for microfinance institutions to emerge in the formal banking world. Banks still face six interrelated obstacles as they seek to operate successful microfinance programs. The discussion of these issues is still preliminary. The information on each bank was gathered from a brief interview of one bank officer attending the conference and from responses by banks to a written questionnaire. Detailed field case studies were not performed for the 17 banks attending the conference.

A. The Policy Environment

The policy arena is of strategic importance for commercial banks. Non-bank microlending NGOs can operate in a repressed financial market environment since they are not subject to the regulatory interest rate ceilings, high reserve requirements, and selective (*i.e.* targeted) credit policies characteristic of these markets. Commercial banks, however, cannot escape these regulations that, in the end, reduce their profit margins. Rarely have commercial banks considered microfinance initiatives while operating under a regime of financial repression. In contrast, markets experiencing substantial financial liberalization offer a far more promising opportunity for experiments in microfinance. Banks are able to charge the relatively high interest rates on microloans required to cover lending and default costs and the opportunity cost of funds.

Table 2.2 indicates that, by the early to mid-1990s, the banks in this study were largely operating in favorable financial markets. The countries in which these banks functioned had all undertaken stabilization efforts from the late 1980s onwards (and some, such as Indonesia and Chile, from much earlier). Low average rates of inflation (column 1) are evident in most countries, with Latin America, on average, registering slightly higher rates than the other regions. Only Ecuador registers an annual rate of inflation in the 20 percent range. Panama is a striking exception. Its currency has been historically tied one to one with the U.S. dollar. Consequently, this country has not experienced the inflationary history of its neighbors nor financial repression; hence, it never needed stabilization policies nor deregulation.

All countries except one have deregulated deposit and loan interest rates (column 4). This has contributed to the emergence of the positive real loan rates shown in column 3, reflecting the strength of the liberalization efforts in these settings by the mid-1990s. Only South Africa has maintained an interest rate ceiling for commercial banks through a restrictive usury law from which it has occasionally allowed limited exemptions. The Standard Bank launched its microenterprise initiative in 1994 with one of these exemptions. In 1996, however, all exemptions had been revoked for regulated banks.

Reserve requirements (column 5) are the other potential impediment for commercial banks considering a commercial platform in microfinance. The higher the reserve requirement, the less the deposit base available for on-lending, the lower are profits, and the less likely banks would consider a novel and initially costly effort in microfinance. For countries with a poorly developed market for government securities, reserve requirements are the classic policy instrument to control inflation. Therefore, in the early stages of stabilization in low income countries, reserve requirements can reach 50 percent or higher, as the authorities exercise heavy controls on monetary expansion in the banking system. Even in countries with relatively well-developed government securities markets (*e.g.*, Latin America), high reserve requirements are a convenient mechanism for governments to secure resources to finance their fiscal deficits. Most of the Latin American countries in Table 2.2 experienced these high reserve requirements in the mid-to-late 1980s. This is one of the reasons why commercial bank microfinance efforts did not emerge in this region until the early 1990s, when these requirements declined to more modest levels. Panama and Chile are exceptions to this pattern, as stabilization was not needed in the former and stabilization occurred much earlier in the later.

Table 2.2: Selected National Financial Market Indicators for Relevant Countries, 1995-96 (Countries Ranked by Within-Region Inflation).

(Countries Ranked by Inflation within Region)	Rate of Inflation 1995-96[a]	Nominal Loan Rate 1995-96[b]	Real Loan Rate 1995-96[c]	Dereg-ulated interest rates	Reserve Req. 1996[d]	Financial Deepening ratio[e] 1989	Financial Deepening ratio[e] 1994
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
<u>Africa</u>							
Uganda	6.9	19.8	13.1	yes	18.9	3.7	9.8
South Africa	7.6	19.3	10.9	no	3.1	55.5	50.4
Egypt	8.1	15.5	6.8	yes	20.6	78.5	97.2
Kenya	11.1	33.4	20.1	yes	20.1	25.3	41.0
<u>Asia</u>							
Philippines	7.0	15.0	7.5	yes	11.9	31.0	41.2
Indonesia	7.3	19.2	11.1	yes	16.6	32.0	37.3
<u>Latin America</u>							
Panama[f]	1.0	10.5	9.4	yes	-	28.6	64.8
Chile	6.7	17.4	10.0	yes	8.0	35.5	34.9
Paraguay	9.4	29.4	18.3	yes	33.1	13.4	24.7
Guyana	9.7	18.1	8.1	yes	19.6	54.6	45.1
El Salvador	9.8	19.2	8.6	yes	34.9	20.5	36.4
Guatemala	11.3	23.6	10.1	yes	31.9	19.4	23.4
Peru	11.8	36.4	23.0	yes	34.9	15.2	34.9
Bolivia	13.4	-	-	yes	13.3	12.5	45.1
Bolivianos	-	30.7	15.2	-	13.3	-	-
Dollars ($)	-	18.8	4.8	-	10.0	-	-
Jamaica	14.4	45.1	26.8	yes	32.9	44.0	40.0
Ecuador	23.4	57.4	27.5	yes	11.3	11.0	30.7

Source: <u>International Financial Statistics</u>, International Monetary Fund, various monthly issues, 1996. Data for Bolivia and Guyana secured from World Bank offices responsible for those countries. Information on deregulated interest rates secured from desk officers at World Bank and Newsletter of <u>Policy Research Development Policy</u>, Inter American Development Bank, Dec. 1996.

a: Average from roughly mid-1995 to mid-1996.

b: Average Prime rate in loan markets from IFS data from mid 1995 to mid 1996.

c: Estimated from $\frac{i-p}{1+p}$ where i = nominal loan rate (col. 2) and p = rate of inflation (col. 1)

d: Estimated from data in <u>International Financial Statistics</u> for first quarter of 1996 (reserves, line 20 as a share of demand, time and savings deposits - lines 24, 25).

e. M2 (demand deposits plus savings and term deposits) to GDP.

f. Panama has no central bank, hence no reserve requirements are recorded in column 5.

The Asian and African countries listed in Table 2.2 experienced less severe stabilization drives since their initial inflation rates were lower. By the mid-1990s, their reserve requirements were generally much lower than those in most of the Latin American countries (Chile and Panama again excepted). Authorities in Paraguay, El Salvador, Guatemala, Peru and Jamaica still administer fairly high reserve requirements growing out of the fiscal deficits that remain in these countries.

Some banks, Banco Empresarial in Guatemala among others, complained that high reserve requirements in their countries were constraining the profit potential of their banks. It is also of interest to note that Bolivia, with an impressive tradition of recent microlending NGOs maturing into bank and near bank institutions, has unusually low reserve requirements and high levels of financial deepening (column 7) by Latin American standards in the mid-1990s.

Finally, it is evident that the financial liberalization measures carried out in these countries have succeeded in increasing the level of financial deepening from 1989 to 1994, the period during which most of these bank-sponsored microenterprise programs were launched or microlending NGOs were transformed into banks (columns 6 and 7) . All countries with low levels of financial deepening in 1989 increased the of M_z to GDP ratio substantially by 1994.[1] This global measure of financial market development underscores the increasingly favorable policy environment for these program initiatives in the early 1990s for most of the countries in this study.

B. Remaining Obstacles for Banks in Microfinance

While important, a favorable policy environment is not sufficient for a successful commercial bank involvement in microfinance. At the level of the financial intermediary, several other conditions contribute to this success. These conditions are discussed below.

1. Commitment and Bank Culture

Commitment at the highest levels of the bank is necessary to make a microfinance program work successfully. Without this support, microfinance programs will not receive the human and financial resources they require to consolidate and expand. Especially for the large, multi-service banks, the issue of commitment is a true constraint. Microfinance programs are so different from conventional corporate banking that they are generally not understood by most mid-level bank managers, and sometimes they are even considered a second-class activity. For corporate bankers, career advancement is generally a function of success with large loan placements, which is rewarded with increased delegation of authority to make even larger loan decisions. In this context, an officer's portfolio of hundreds of tiny loans adding up to a small dollar volume is not a sign of success or a promising path for career advancement in the institution.

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[1] The unusually low ratio for financial deepening in Panama in 1989 reflects the capital flight associated with the period leading up to the fall of Noriega, the high ratio in 1994 reflects the renewed post-Noriega role as an offshore banking site for funds from overseas.

These organizational threats to the program appear to be most critical in cases where the microfinance unit competes for resources and status with other bank divisions (corporate, international). Many bankers at the conference reported that it was difficult to work in an unsupportive corporate culture. The lack of strong commitment and of an accepting bank culture appears to explain in part the short life of the microenterprise program at the Standard Bank of South Africa. Even one of the first entrants in microfinance, the Banco del Pacífico in Ecuador, has maintained only a small microfinance program in a large corporate structure. After 23 years of operations in microfinance, it only has 4,000 active loan clients.

Part of the problem appears to lie in the fact that the programs initiated in larger full-service or corporate banks are usually established to fulfill a particular vision of an individual founder, owner or board member. Unfortunately, this vision is not always translated into a clearly defined and articulated institutional mission and its associated structure, and it often lacks widespread support from mid-level managers. As a result, the microfinance unit becomes the special project of a protective bank leader. At the conference, three of the bankers expressed concern over the future survival of the bank's microfinance efforts once their protector left.

Nevertheless, most of the large banks are funding their microenterprise programs out of their own deposit resources with relatively minor reliance on donor or government funds. Most of the large banks are risking millions of dollars of their own deposit or equity base to fund these programs. Banco Wiese, for example, funds the entire US $19 million microenterprise portfolio from internal sources. While this is a sure reflection of current commitment, given that most microenterprise programs are relatively young it is hard to tell whether this commitment will be long-lasting. As will be noted below, administrative designs that separate microfinance more explicitly from the rest of the bank may offer the large banks a solution to the problem of an unsupportive bank culture. The high opportunity cost of using the bank's own resources, however, still remains an issue.

As already pointed out, small and specialized banks appear to have a stronger institutional commitment to microfinance. These banks generally have few shareholders, which facilitates the formulation of narrower institutional missions. All of the small and specialized banks have small ownership structures and most have larger percentages (in some cases all) of their portfolio in microfinance. Thus, their institutional culture is geared towards servicing a lower-income clientele with specialized products.

2. Administrative Structure

For the large, multi-service banks, the administrative structure of the microfinance unit is particularly difficult to design. Among the large banks interviewed, we found four administrative approaches:

Independent Structures

1) Fully-independent microenterprise retail centers, affiliated to the bank but with their own lending policies, staff, and information systems, which report to the larger bank: Banco del

Desarrollo's microfinance subsidiary in Chile, the Unit Desa system of the BRI in Indonesia, the Scotia Enterprises Program of the Nova Scotia Bank in Guyana.

2) Lending through non-governmental organizations (NGOs) which in turn on-lend to microenterprise clients: Banco Wiese in Peru.

Integrated Structures

3) Semi-independent microenterprise units lending directly and/or with specialized windows in each bank branch, staffed with a microfinance credit officer. Administrative and financial functions are integrated into the larger bank: Banco Agrícola Comercial, Banco del Pacífico, Financiera Familiar.

4) Fully-integrated operations, wherein the small-business credit officers also handle micro-enterprise clients. All administrative, personnel, and financial systems are integrated: Centenary, Multi-credit Bank, Caja de Ahorro y Crédito Los Andes.

In general, it appears that the more specialized and independent the microfinance unit, the easier it is to institute appropriate microfinance lending technologies and policies and to avoid interference from the larger bank culture. This was clearly evident with banks that had organized fully-independent centers or subsidiaries which in turn managed their own retail outlets and were structurally shielded from the rest of the bank (Banco del Desarrollo, BRI, and Nova Scotia Bank). Perhaps the most dramatic example is Scotia Enterprises, which operates a group-lending program with loans mostly under US $300 (one of the very few banks doing so), under the umbrella of a large, sophisticated, foreign-owned commercial bank. While this autonomy represents an additional cost to these banks, it appears to generate a positive tradeoff in that it secures an appropriately-structured operating environment for the microfinance activity.

Wholesale lending directly through NGOs was reported in at least one bank, Banco Wiese of Peru. This approach could be an option for some other large national banks interested in reaching out to a microenterprise clientele in so far as there is a promising set of microlending NGOs in the country. The challenge here lies in the correct selection of solvent NGO microfinance programs and the structuring of clear, efficient, and mutually beneficial relationships between the NGOs and the bank. Here the bank is the principal and the NGOs are the agents. Monitoring (*i.e.*, agency costs) are still involved, but the bank may find this contractual design easier. In short, it may be able to design compatible incentives for the NGOs to fulfill their contractual obligations than trying to lend directly to microentrepreneurs. If successful, this on-lending alternative creates a win-win situation, freeing the bank of the administrative burden of direct microlending while, at the same time, enhancing its public image. The NGO, in turn, secures a source of funding for its microenterprise clientele without engaging in the costly and difficult task of mobilizing its own deposit base (if ever) before it is fully prepared to do so and be freer to charge high, cost covering interest rates than banks may be able to do.

A solution loaded with difficulties has been that of fully integrating microfinancial services into larger commercial banks, using traditional individual loan technologies and expecting credit officers to handle microfinance as well as small and medium business lending. The disincentive for credit officers to attend to the microfinance clients was evident in the Banco Agrícola Comercial in El Salvador, for example, which reported substantially fewer microloans from its branches where credit officers handled all lending than from its microenterprise unit. Unfortunately, although the microenterprise unit was authorized to engage in direct microlending, it lacked independence and answered to the bank's consumer lending department. Financiera Familiar in Paraguay, however, appeared to have had more success in incorporating its microlending into its consumer lending units. Banco del Desarrollo in Chile and the National Development Bank of Egypt utilized their branch networks and created specialized microlending units in their branches.

Administrative design issues were less problematic for the smaller and more specialized institutions in Table 2.1, since these institutions had more substantial microfinance programs. Banco Empresarial may be an exception. As an institution dedicated to small and medium sized businesses by institutional mandate, this bank was attempting to modify its conventional individual loan methodology to reach microenterprise clients. At the same time, the bank has tried to reach more microenterprise clients by setting up loan windows in department stores and supermarkets and by changing banking hours to coincide with shop and store hours. This greatly reduces transaction costs for borrowers and creates the potential for greater scale economies in the future.

3. Financial Technologies

Microlending

Over the years, non-governmental organizations in microfinance have developed innovative lending technologies to reach poor clients with micro- loans. They have borrowed many of their practices from informal finance. Absence of these technologies explains, in part, why formal lending institutions such as banks have traditionally had difficulty reaching microclients. Some of the principal characteristics of the microlending technologies are:

* short-term, working capital loans
* lending based on character, rather than collateral
* sequential loans, starting small and increasing in size
* group loan mechanisms as a collateral substitute
* quick cash flow analysis of businesses and households, especially for individual loan technologies
* prompt loan disbursement and simple loan procedures
* frequent repayment schedules to facilitate monitoring of borrowers
* interest rates considerably higher than those for larger bank customers to cover all costs of the microfinance program
* prompt loan collection procedures
* simple lending facilities, close to the clientele

* staff drawn from the local communities with access to information about potential clients
* computerization with special software to allow loan tracking for larger programs.

While the large, multi-service banks have important comparative advantages to reach out to large numbers of clients through branch networks, microlending methods are foreign to them and must be assimilated. It is not enough to simply reach further down with the conventional banking technology. Large banks which have successfully made the jump to specialized microfinance tend also to be those that have radically separated the program from the rest of the bank. The BRI, the Banco del Desarrollo, the Bank of Nova Scotia, and the Banco Wiese are examples of this trend.

Those institutions with programs integrated into the conventional bank structure tend to have greater difficulty in implementing the specialized microfinance technology. Interest rates present a thorny issue for some integrated programs. Many banks charged the same rate of interest for microenterprise loans as to their regular clients, although they knew the former levied higher costs. When asked why, they usually explained that the bank would receive bad publicity if it charged higher rates to poorer clients.

Many of the banks had not adopted other microfinance best practice technologies. They had minimum terms to maturity that were too long, such as 12 months; maximum loan terms were also too long, some up to six years. Bank offices were somewhat removed from the microenterprise clientele. Collection procedures emphasized past-due letters as opposed to prompt visits from the credit officer. Collection responsibilities were assigned to the bank's loan collection department rather than to the microfinance program itself. Loan procedures did not differentiate between first-time and repeat loans.

Most banks provided loans without requiring real estate collateral (although the BRI uses the borrower's house plot and Centenary Bank would try to secure liens on business premises). Banks with larger microloans tended to require clients to pledge personal property and household goods or find cosigners. Banks with smaller loans relied more heavily on references and character-based information.

By and large, the small and specialized banks had adopted more elements of the financial technology described above, and some had even instituted interesting innovations. Financiera Familiar, for example, had implemented a smart card for its clients, such that processing for third and subsequent loans took only 20 minutes. Centenary Bank and Caja Los Andes followed a similar pattern whereby an immediate credit line is made available without further credit analysis for perfect repayers after two loans. This greatly reduces both lending and borrowing costs. The smart card technology for these three institutions was introduced through technical assistance from IPC/Frankfurt.

While all of the banks have instituted some microfinance techniques and innovations, only a few have carefully thought through all of the elements of their financial product. After the conference, many bankers confessed a need to adjust their loan prices and their operating procedures.

Microdeposits

The new microfinance bankers knew relatively little about deposit mobilization technologies that reach the low-income and/or microenterprise client. There were some notable exceptions, however, such as the BRI and the Bank Dagang Bali. Perhaps best known is the BRI Unit Desa savings program, which has the following characteristics:

Features attractive to the microclient:

* liquid passbook savings accounts and low minimum balances
* depositories conveniently located
* secure deposits
* real, positive interest rates on deposits

Operational features of the program:

* savings accounts with very low minimum balances
* lower levels of interest, compared to commercial banks, because of higher administrative costs
* simple, hospitable buildings and mobile units with low overhead
* simple administrative forms and procedures
* courteous and friendly staff
* incentives for savings, such as lotteries

Although all the banks interviewed were authorized to capture deposits, only four (Bank Dagang Bali, BRI, Standard Bank, Worker's Bank) had instituted large-scale programs or campaigns explicitly to attract very small depositors. Most of the microfinance bankers at the conference were heads of lending units, and had no relationship whatsoever to deposit-taking. This focus on lending is not surprising, since donor funds, which have contributed to the entry of many of these banks into microfinance, have concentrated on credit programs.

Most banks reported having savings accounts with small balances under $500. Some had substantial numbers, such as the Banco Agrícola Comercial with 38,169 savings accounts under $500, or the Centenary Bank in Uganda with 42,000. Unlike the programs of the BRI, Worker's Bank, Bank Dagang Bali and Standard Bank, which were focused on reaching a specific target market, these did not appear to require a concerted effort to reach a large low-income population. Centenary, for example, allowed for a minimum savings balance of only $10 dollars whereas other banks in Uganda require $50 dollars. This general deposit policy was sufficient to attract large numbers of small savers.

4. Human Resources

Up to recently microfinance technologies have been labor-intensive, and all the bankers interviewed evinced special concern for recruitment, training, and motivation of staff.

Recruitment

Most banks hired microfinance staff from outside the bank and preferred young university graduates with little if any banking experience. The lack of a banking background apparently made them more receptive to the special mission and practices of the microfinance program. This is consistent with findings in other microfinance institutions (Rhyne and Rotblatt, 1994). There was some disagreement over the minimum qualifications for a credit officer. Some banks considered that credit staff should have university degrees, coupled with a social service mind-set. The Banco del Pacífico, for example, required a degree, since its credit promoters also provide clients with business development advice. Unfortunately, such qualifications drive up operating expenses, since salaries are the single largest expense item in microfinance programs. In the case of the BRI and the Banco Wiese, NGO promoters were generally high school graduates from the same social class as the clientele.

The most common feature among loan officers was that they were typically recruited from the local areas where the bank's microfinance unit operated and micro loans were made. This feature allegedly allowed loan officers to conduct their loan screening and monitoring efforts efficiently since they were familiar with the local clientele and their activities. One exception to this practice was noted in Uganda, where Centenary Bank does not assign its loan officers to their home areas to avoid the perceived negative impact of strong kinship pressures on effective loan administration.

Another important impact of cultural values influencing loan administration concerns women loan officers in Centenary Bank. It is not acceptable for women to ride motorbikes in Uganda, especially outside the capital city of Kampala. Hence, women loan officers (who comprise roughly 25 percent of total loan officers) cannot be used with clienteles that live beyond the means of public transportation. This restricts the area that can be served by these officers. Also, it is not easy for women officers to handle male clients, particularly those who become delinquent borrowers, without a male team member to assist in these sometimes disputatious meetings. It makes more sense to use women officers to focus more on building up the base of women clienteles where these impediments are absent.

Staff Training

Fourteen of the seventeen banks (both large and small) reported in-house, on-the-job training for new staff. This specialized training is costly, but probably a necessity. All banks require their staff to be familiar with microfinance technologies and operating systems and procedures, and they hold meetings clearly articulating the institutional mission in microfinance. Of the sample banks studied, the BRI had the most highly-developed training program. To maintain a staff of over 14,000, the Unit Desa program has five regional training centers at which approximately 6,000 employees are trained each year. BancoSol and Caja Los Andes have also expanded rapidly, ranking among the most successful originators and adapters of new microfinance technologies in the banking world. The former stands out as one of the preeminent programs in group loan technology, the latter one of the leaders in individual loan technology. Both institutions had strong staff training programs as a catalyst to incorporate these technologies successfully, drawing heavily upon specialized foreign assistance NGOs/firms, Accion International for BancoSol and IPC/Frankfurt for Caja Los Andes.

Staff Remuneration and Incentives

Studies of successful microfinance NGOs reveal that credit officer salaries tend to be lower than those found in conventional commercial banking. This is due to the fact that these programs, by nature, are highly labor intensive and hence costly. For the large bank integrated microfinance programs, however, salary levels can present some difficulties. In one case, salary scales were different and a performance-based bonus remuneration scheme existed for the microfinance staff. This created some tension with non-microfinance bank staff who earned conventional fixed salaries. Most others use the same salary structure of the rest of the bank. In at least three cases, no bonus system existed, perhaps because the salaries were considered adequate already. Banks that have independent microfinance units are able to have their own lower salary scale and introduce bonus schemes without drawing much attention from the rest of the bank staff.

More generally, the best practice institutions have strong incentive systems in place to motivate productivity. Programs must be productive in order to lower costs. Among the bank sample, only five out of seventeen banks did not have some kind of bonus system. Four of those five banks were large national banks with extensive branch networks. Those that had incentive systems generally had either:

a) bonuses for the individual or a team, based on productivity and profitability, or

b) distributions to all staff based on profitability of the overall bank.

The small and specialized banks and the fully-independent subsidiaries of banks tend to offer bonuses oriented specifically to enhance the individual or team's productivity. Financiera Familiar in Paraguay, Centenary in Uganda, and Caja de Ahorro y Crédito Los Andes in Bolivia reported staff incentive systems based on a formula of three key variables: quality of portfolio (measured by levels of delinquency), volume of lending and number of active loans. The Financiera Familiar reviewed staff performance monthly, and paid bonuses to each individual officer. Caja de Los Andes reported that incentives sparked staff productivity. Los Andes credit officers carry impressive case loads of up to 700 individual loan clients.

Bonus remuneration schemes are justified for individual microloan technologies since loan officers are engaged in demanding and time-consuming client evaluation practices. Given the highly discretionary element of individual judgement and commitment to hard work to carry out this task satisfactorily, it is felt that a good part of the loan officers' remuneration should reflect how well he or she carries out this task. Good judgement in client selection and evaluation and diligent work to ensure effective monitoring and loan recovery are essential for a well-performing individual loan portfolio.

The BRI also has a well-developed system, wherein 10 percent of the profits of each Unit Desa are distributed to the Unit Desa staff, usually a team of 4 or 5 people. Some of the larger, multi-service banks had general distributions depending on whether the bank had a good year.

In summary, the most important question is not the level of salaries. It is the optimal distribution between the fixed salary and bonus portion of the remuneration. The purpose here is to solve important principal-agent problems, *i.e.*, create incentives for loan officers to carry out their highly discretionary credit evaluations of clients responsibly. The measurement and monitoring of staff productivity is not trivial in microfinance and many of the most important efforts of client evaluation cannot be easily observed by supervisors. Hence, performance-based bonus incentives become an important part of loan officer remuneration, particularly for programs emphasizing individual loan technologies.

5. Cost-Effectiveness

Yet another issue of concern at the microfinance conference was cost reduction. While most bankers claimed that their programs were profitable (no specific figures were provided), they were nevertheless under the impression that costs were still too high.

There appear to be a number of strategies to reduce costs. First, many banks could use a fuller implementation of the microfinance technologies mentioned above. For example, many banks had high salary structures that could be reduced by recruiting non-university degree staff. However, a caveat is in order here since the salary savings gained through hiring less educated staff could be more than offset by lower productivity. Other banks could experiment more fully with alternatives to lengthy individual business analysis techniques. Most could improve staff productivity levels through improved operating procedures and incentive systems.

Second, banks could explore new technologies to expand lending. For example, the smart card option of Financiera Familiar appeared to be an excellent cost-cutter for processing repeat loans. It was also well received by clients, who enjoyed carrying their plastic status symbol. The credit line approach followed by Caja de Ahorro y Crédito Los Andes and Centenary also comes to mind here as effective cost savings for good repeat customers.

Third, independent profit or cost centers may be a cost-effective strategy for many of the large, multi-service banks. Although initially costly, the separation of programs helps to isolate the costs of the microfinance program and identify appropriate cost-saving measures.

Finally, rather than reduce costs, many banks may need to increase their interest rates and simply accept the fact that microfinance programs are costlier. The eight banks that reported on non-financial costs as a percentage of the loan portfolio provided estimates ranging from 2 to 23 percent with one outlier at 85 percent. The upper range of these figures in the 20 percent range are close to those measured for successful NGO microfinance institutions using best practices (Christen, Rhyne, Vogel, and McKean, 1995).

Although microfinance bankers complain of high costs, it is unclear that their programs are in fact costlier than those of financial NGOs or specialized institutions such as BancoSol and Caja de Ahorro y Crédito Los Andes. Costs for microfinance are simply higher than those for conventional banking. What is also unclear, however, is whether the integrated programs are fully aware of the costs of the microfinance program. As noted earlier, in most of these cases administrative functions are handled by a centralized staff. Until there is a greater separation of costs in these programs, and until banks with microfinance programs feel freer to share income and expense data, the question of costs will remain largely an open question.

6. Regulation and Supervision

Most of the participants at the conference reported concerns about regulation and supervision. Three worries predominated: high legal reserve requirements, burdensome reporting requirements, and inappropriate criteria for loan portfolio classification and provisioning.

Legal Reserve Requirements: In many developing countries, legal reserves on deposits are extremely high, in essence discouraging savings mobilization. Banks will be less likely to utilize their own, scarcer resources for microenterprise programs in this environment. As pointed out earlier in the discussion of the policy environment, reserve requirements have been lowered in most countries from those the banks experienced in the late 1980s. Still they are moderately high for five Latin American countries represented at the Conference and no doubt influence the degree of microlending undertaken in these countries.

Reporting Requirements: Sophisticated information systems are required to track and report on a voluminous microfinance portfolio. Only a few of the banks at the conference had large numbers (greater than 15,000) of loans outstanding at present (BRI, BancoSol, Caja Los Andes, NBD), so the experience on this front is still sketchy. Nevertheless, Banco Empresarial along with several others complained about the burdensome reporting requirements in their countries.

Loan classification and provisioning: The regulatory issues of loan classification and provisioning for microfinance manifest themselves differently in different institutional frameworks. Private commercial banks with an established regulatory track record and a long history of operating from an established deposit base before launching a microenterprise program are subject to less risk compared to credit-only NGOs just launching a deposit mobilization effort. These banks typically make their own provisions for their undercollateralized micro clientele and have an interest in watching the bottom line closely given the opportunity cost of capital devoted to these programs. Authorities, however, may introduce reporting requirements that can generate transaction costs if they become too detailed.

Capital adequacy: Microlending NGOs represent greater risk as they move from their original credit-only product lines into deposit taking for the first time. In contrast to already established private commercial banks, these new banks typically do not draw upon private equity stake-holders in any significant fashion. They generally build on donor-sponsored equity holdings and/or employee shares. This unusual governance structure means that the equity owners would not be able to quickly supply new capital in a crisis generated by a shortfall in revenue. This points to the need to have these institutions meet higher capital adequacy standards than those associated with conventional banks (Rock and Otero, 1997, chapter II).

On-site examinations: Unconventional governance structures imply that management may not be under a strict monitoring regime, thereby increasing management risk. This issue was widely discussed in the open sessions of the conference as the classic source of risk in these newly-emerging banks derived from microlending NGOs. This feature, combined with covariant risk (most clients subject to the same localized income shocks), underscores the volatility of their revenues. In short, volatile revenues and the inability to muster new capital quickly to service liquidity crises require that bank examiners devise new methods of site visits to determine the health of these portfolios. Merely inspecting the adequacy of collateral guarantees is inappropriate for these institutions. Discussion at the conference highlighted the usefulness of a random sampling framework to determine the share of performing and non-performing loans and documentation through site visits on the degree to which management personnel are following correct procedures and guidelines set forth in the institution's credit manual. Finally, the contract-enforcement environment for the microenterprise community could be improved if the regulatory authorities maintained a credit rating list of defaulted borrowers with individual loans. This information could be shared within the microfinance community to forestall the potential weakening of other institutions to whom these borrowers might turn for new loans (Rock and Otero, 1997).

CHAPTER THREE: COMMERCIAL BANKS AND MICROFINANCE: AN EMPIRICAL PROFILE

I. Institutional Performance

A. Outreach: Breadth and Depth

This chapter presents an empirical profile of the microfinancial activity for each of the banks in this study, detailing comparatively the principal parameters of institutional performance, organizational structure, products and lending technology. Indicators presented in Table 3.1 provide a sketch of the outreach of a number of commercial banks engaged in the provision of microfinancial services across different regions of the world.[2] The term *commercial banks* will be used throughout this chapter to refer both to the commercial banks and the few non-bank regulated financial intermediaries that will be discussed subsequently.

First, the only state-owned bank in Table 3.1, the BRI of Indonesia, is clearly in a world of its own in the breadth of its microloan market. The numbers reached are above 2.4 million. The BRI has a much larger network of offices (unit desas), numbering in the thousands, drawing business from one of the most densely inhabited and dynamic rural areas in the world (Java), and it has a longer history of microlending activity than most of the remaining banks in Table 3.1. Hence, the number and volume of its microloans dwarfs the efforts of the private banks which, for the most part, have only launched their programs more recently, on a smaller scale, and in less densely populated markets. Nevertheless, most of the remaining discussion will emphasize these private commercial banks since they represent the new actors in the microfinance arena.

Second, the total number of micro and small loans outstanding,[3] the criteria used to rank these banks within Africa, Asia, and Latin America respectively, reflects a more modest outreach at best for the

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[2] The banks discussed in this chapter were represented at the Conference on "Commercial Banks in Microfinance," held in Washington, D.C., November 18-20, 1996 under the auspices of the Agency for International Development, Microenterprise Office, Washington, D.C. The information used in this chapter is based on data reported by the respective bankers at the conference.

[3] The term *micro and small loans* is used here to refer to the category of loans provided by commercial banks that are granted in loan amounts much smaller than the average bank loans and with terms and conditions that are usually different from those typical of commercial lending in these organizations. These loan sizes and terms and conditions will undoubtedly vary by country depending on the poverty level, income per capita, and the nature of the economy. Banks with no specialized microenterprise programs were asked to report information about their *small-loan* category, which included loans below US$5,000.

highest ranked private banks in each region.[4] These banks are the National Bank for Development (NBD) in Egypt, the Bank Dagang Bali (BDB) in Indonesia, and BancoSol and Caja de Ahorro y Crédito Los Andes in Bolivia. The National Bank for Development in Egypt is the only large organization among these three institutions. Interestingly, however, Banco del Desarrollo in Chile, which has the third largest number of micro and small loans outstanding in Latin America, and Banco Agrícola Comercial in El Salvador, which has the fourth largest number of loans disbursed, are also large organizations. This suggests a potential for growth in their microloan programs.

Third, along with having the largest number of outstanding loans, the National Bank for Development in Egypt, the Bank Dangang Bali in Indonesia, and BancoSol and Caja de Ahorro y Crédito Los Andes in Bolivia also disbursed the largest number of micro and small loans as well as the largest total volume of micro and small loans during the preceding year in their respective regions. Given differences in average loan size and terms that the various banks offer, however, these indicators have to be further examined.

Fourth, one can usefully compare the number of loans disbursed to the number of loans outstanding. If the ratio is greater than one, the portfolio consists largely of loans with a term to maturity of less than a year. If the ratio is close to or equal to one, the portfolio's term structure is on average around one year in maturity. Finally, if the ratio is less than one, the bank has a portfolio of term loans longer than a year. Column 5 of Table 3.1 underscores the existence of two types of banks, those with a bias for longer-term loans and those emphasizing short-term loans in their microloan portfolio. A substantial majority of banks register ratios less than one, indicating a proclivity for longer-term loans. Only four banks, the National Bank for Development in Egypt, Centenary Bank in Uganda, and BancoSol and Caja de Ahorro y Crédito Los Andes in Bolivia show ratios greater than one. Moreover, the ratios for the latter two are considerably greater than one, indicating a strong bias for shorter-term loans in these institutions. In summary, the results of a bias for longer-term loans in the majority of these commercial banks is in sharp contrast to the shorter-term loans characteristic of most microlending NGOs. This is an indication of lack of adoption of typical microlending technologies.

Fifth, it is important to recognize the proportion of micro and small loans in the total portfolio. On the one hand, this indicator reflects the degree to which the bank in question reaches a micro and small clientele among its customers. On the other hand, this proportion highlights the potential for growth for this loan category within the bank. With the exception of the large state-owned BRI, the figures reported in Table 3.2 (column 6) indicate that only a few banks have largely concentrated their lending portfolio in the microfinance area: the Family Finance Building Society in Kenya, the Centenary Bank in Uganda, Bank Dangang Bali in Indonesia, and BancoSol and Caja de Ahorro y Crédito Los Andes in Bolivia. It is important to note that these organizations have been largely specialized in micro and small loans since their inception, either as microlending NGOs (BancoSol

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[4] The statistics, self-reported by the banks, indicate both micro and small loans. For convenience of abbreviation, column headings in the tables merely use the term *micro loans*. This is reasonable in light of the fact that a large majority of the total number of loans are micro loans.

and Los Andes) or as banks (the other three institutions). In addition, two of these organizations, namely Centenary Bank in Uganda and Caja de Ahorro y Crédito Los Andes in Bolivia continue to receive substantial technical assistance from the German Consulting firm Interdisziplinare Projekt Consult (IPC) with regard to the provision of microfinancial services for the poor, while BancoSol benefited from technical assistance through a number of USAID-supported organizations (especially Accion International) to also reach the poor.

Sixth, the majority of the large multi-service commercial banks, in constrast, have a very small share of their lending portfolio in this area: the National Bank for Development in Egypt, Banco Agrícola Comercial in El Salvador, Banco Pacífico in Ecuador, Nova Scotia Bank in Guyana, and the Workers' Bank in Jamaica. Interestingly, however, most banks, whether having a large or a small share of their portfolio invested in microlending, are using their own deposit base either to fully or partially support this activity. This implies that there may be a large growth potential for this micro loan category as it competes with more traditional banking products in the larger banks. As highlighted in the previous chapter, the degree to which these banks will allow more of their deposit base to support microlending will depend on the opportunity cost of using these deposits for microfinance compared to returns for use elsewhere in the bank.

Seventh, the proportion of women borrowers in the micro and small loan portfolio reflects a dimension of the depth of the outreach of these organizations. Women are an important segment of the disadvantaged clientele. Again, figures in Table 3.2 (column 7) indicate that the experiences vary from reaching a majority of women clients in Bolivia by BancoSol, in Indonesia by the Bank Dangang Bali, in El Salvador by Banco Agrícola Comercial, in Guyana by Scotia Enterprises, and in South Africa by Standard Bank, to reaching a smaller percentage of women in Egypt by the National Bank for Development, in Kenya by Family Finance Building Society, in Uganda by Centenary Bank, and in Guatemala by Banco Empresarial. More detailed field studies are required to identify the factors generating these gender differentials by institution. The differential targeting of certain market niches by occupation or activity (*e.g.* retail outlets in markets) and/or the product (group lending, short loan terms) could possibly explain these differences.

B. Sustainability: Initial Cross Subsidization and Sources of Funding

Microfinance units within these organizations are roughly divided evenly between integrated and separate entities. Integrated units standout in the smaller more specialized institutions while separate units are largely associated with the larger banks (Table 3.3 column 2). Initial cross subsidization of the microfinance unit for various periods of time was reported by all the organizations. To the extent that these programs later become profitable for the bank, it is inappropriate to refer to this strategy as subsidization; hence the term "initial" cross subsidization is used here. Most of the organizations are at least breaking-even now, if not making profits in their microfinance operations. A few programs which continue to be cross-subsidized have either faced some economic shocks, such as Banco del Pacífico in Ecuador, because of the country's recent civil disturbances, or it is still too early in the program's life, such as the Workers' Bank in Jamaica and Banco Empresarial in Guatemala, or because the microfinance activities are merged with other activities, such as consumer and micro loans as in Banco Agrícola Comercial in El Salvador. In the case of the Panabo Rural Bank in the Philippines, microfinance activities, although not separated from the bank's lending portfolio, were reported to be quite profitable.

Initial cross-subsidization or grants have been used to cover initial sunk costs and operating costs typically for a period ranging between two to three years, as with the National Bank for Development in Egypt, Centenary Bank in Uganda, Family Finance Building Society in Kenya, Scotia Enterprise in Guyana, and Financiera Familiar in Paraguay. Other programs reported subsidizing their microfinance units for 3 years (in the case of Standard Bank in South Africa), 4 years (in the case of Multicredit Bank in Panama), and up to 5 years (in the case of Banco Wiese in Peru). The former microlending NGOs that became a bank and a *fondo financiero privado* in Bolivia (BancoSol and Caja Los Andes) are really not involved in cross-subsidization in the same sense as already established commercial banks, since their microloan portfolios are the basic mission of these institutions and they have only recently launched deposit-taking activity. These organizations required substantial donor subsidies, however, before becoming profitable.

Most organizations did not have data readily available at the conference to indicate their average operating costs per loan (Table 3.3 column 5). The few that provided this information reported figures that varied from the single digits (such as 3 percent for Bank Dangang Bali), to the teens (such as 12 percent for Financiera Familiar and Bank Rakyat Indonesia, and 14 percent for Banco del Desarrollo), to the twenties (such as 20 percent for FFBS, 21 percent for Multicredit, and 23 percent for Caja Los Andes), to the forties for the Centenary Bank. Several organizations that reported very high operating costs, Banco Empresarial in Guatemala (85 percent) and Banco del Pacífico in Ecuador, are among the few banks that appear not to be currently covering the costs of their microfinance activities.

The majority of the organizations relied substantially on their own deposit base as a source of funds to launch microfinance activities, with the exception of Caja de Ahorro y Crédito Los Andes in Bolivia and the National Bank for Development in Egypt. Some organizations, such as the BRI and Centenary Bank, however, have also benefited from donor-subsidized technical assistance efforts that supported the build up of their microfinance activities while others, such as the Family Finance Building Society in Kenya and Centenary Bank in Uganda, also benefited from a small amount of donor fund contributions for on-lending (but these amounted to less than 10 percent of their micro loan portfolio). At the same time, donor funds targeted to microfinance were injected in a number of institutions for on-lending as well as to support initial operational costs until the programs break-even. Among these institutions are the National Bank for Development in Egypt, Caja de Ahorro y Crédito Los Andes in Bolivia, Financiera Familiar in Paraguay, and the Workers' Bank in Jamaica.

Government rediscount lines were used extensively in some cases to supplement the partial use of own deposits, in Banco Agrícola Comercial in El Salvador, Banco del Desarrollo in Chile (40 percent of lending portfolio in each case), and to a lesser extent in other cases, such as the Bank Dangang Bali, Panabo Rural Bank and Banco del Pacífico (less than 10 percent in each case). In all cases where donor or government funds were drawn upon, these organizations also used their own deposit base for their microfinance activities. The bank's deposit base carries the highest cost of funds when compared to donor and government resources. The effective interest rates for micro loans are sufficiently high, however, to cover the cost of funds as well as most operating costs.

II. Organizational Structure and Regulation

A. Governance Structure and Commitment

All the organizations in the sample are private commercial banks with the exception of the Bank Rakyat Indonesia (BRI) which is a state-owned institution (Table 3.2, column 1).[5] On the one hand, larger banks, such as the National Bank for Development in Egypt, Standard Bank in South Africa, Banco del Desarrollo in Chile, Banco Agrícola Comercial in El Salvador, and the Workers' Bank in Jamaica, are characterized by a large number of shareholders (column 2). On the other hand, smaller banks, such as the Family Finance Building Society in Kenya, Bank Dangang Bali in Indonesia, Panabo Rural Bank in the Philippines, BancoSol and Caja Los Andes in Bolivia, Multicredit Bank in Panama, and Financiera Familiar in Paraguay, are characterized by a small number of shareholders. The trend exhibited by the banks under study reflects, on the one hand, a small degree of commitment to microfinance activities (proxied by the share of micro loans in the total portfolio) within the banks with many shareholders, mainly the large multi-service banks. The majority of the banks with few shareholders, *i.e.* the small and specialized banks, on the other hand, exhibit a modest to strong degree of commitment to their microfinance activities, as indicated in Table 3.2 (column 3).

It should be noted that the number of years the banks have been active in the microfinance area does not seem to have a direct bearing on the degree of commitment to this activity. The experience of most private commercial banks in microfinance has only been recent, *i.e.* it covers only a handful of years (Table 3.2, column 4). Five out of the seven largest programs in Table 3.2 have a strong ("extensive") commitment to microfinance lending (column 3). These are also programs with relatively longer institutional histories from 6 to 26 years. Four out of the six youngest programs (5 years or less), which are also among the smaller-sized programs, also document an extensive commitment. Hence, neither age nor size of program are systematically associated with strength of commitment. Finally, one should still recognize that even a small share of microlending and limited

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[5] Again, the term *private* commercial banks loosely refers to all the organizations discussed in this chapter except for Bank Rakyat Indonesia, which is a state-owned bank. While most of these banks are private commercial banks, one, Scotia Enterprise, is a subsidiary of the Nova Scotia Bank; another, Caja Los Andes, has a special private financial institution charter from Bolivian authorities which restricts dealing in international foreign exchange transactions and demand deposits but allows savings deposits; a third, FFBS, is a building society in Kenya while a fourth, Financiera Familiar in Paraguay, is a finance company with the right to offer savings services but not demand deposits. All these institutions fall under the regulatory authority for banks in their respective countries.

commitment can still generate a large number of micro clients in absolute numbers, as can be seen for the National Bank for Development in Egypt (35,850 clients) in column 3 of Table 3.1.

It is not uncommon to find commercial banks and non-bank institutions engaged in microfinance as a result of significant donor support, both in terms of access to funds for on-lending at below market interest rates as well as free technical assistance, particularly during the first few years of the inception of these activities (Table 3.3, column 3). Whether few or many shareholders are involved, a number of organizations have started their microfinance programs based on donor support either in separate units or as an integrated part of the portfolio of the bank (Table 3.3, column 2). The National Bank for Development in Egypt and Workers' Bank in Jamaica received support from USAID to initiate their microfinance activities. Centenary Bank in Uganda and Caja de Ahorro y Crédito Los Andes in Bolivia received support from GTZ, Financiera Familiar in Paraguay received support from the IDB, while the Banco del Desarrollo in Chile benefited from subsidized funds due to interest rebates from the government. Such support allows for an initial subsidy for these programs that, jointly with some of the banks' sunk costs, such as use of the existing infrastructure, utilities, and the bank's reputation gives an advantage to microfinance activities within these organizations until they break even.

Several questions emerge from this use of donor resources and technical assistance to develop microfinance programs in banks: (1) what is the most efficient instrument for the subsidy (cheap funds, technical assistance, guarantees, etc.)?, (2) what is the most appropriate level of the subsidy and for how long should it be granted? In large part the answers depend on each banks peculiar needs to launch their respective programs.

Finally, a number of bankers, particularly those from downscaling institutions attempting to incorporate microfinance services into their lending activities, agree that microfinance has a different culture than their traditional banking services. As noted in Chapter Two, this condition has pushed many bankers to create a separate microfinance unit and not integrate it within their traditional banking organization. This could have implications on the viability of this unit. A stand-alone operation is likely to be more costly than one that could be successfully integrated as a part of the bank's on-going branch lending.

B. Regulatory Environment

Table 2.2 in Chapter Two documented the regulatory environment in the countries in which these banks operate. With one exception, South Africa, all interest rates had been deregulated, creating the opportunity to freely charge the higher more realistic interest rates required for microlending. Moreover, these rates have allowed substantial intermediation margins for a number of these banks, as can be seen by comparing average deposit rates (in column 2 of Table 3.6) to effective microloan rates (in column 3). A portion of this margin is accounted for by reserve requirements on deposits. Reserve requirements were still high in Guatemala and El Salvador and elicited complaints from the banks operating there (see Table 3.1, column 1).

Reporting requirements and special reserves, although commonly perceived as a threat to stifle microfinance activities, did not raise burdensome requirements for the large banks represented in this study. For most large banks, additional conditions to be met for microfinance activities were not substantially burdensome to discourage microfinance initiatives. Moreover, with the exception of South Africa, where Standard Bank had to obtain permission to be exempt from the usury interest law, regulatory authorities did not impose any restrictions on the pricing of microfinance products.[6] This may be due to the fact that microfinance lending has not reached levels that would attract regulatory interest or, in the larger banks, special reserves for undercollateralized loans can be currently handled internally at modest cost. However, there were some burdensome reporting requirements for smaller banks (*e.g.* Banco Empresarial in Guatemala). Moreover, former NGOs transforming themselves into banks (BancoSol and Caja Los Andes) did experience unusual scrutiny and review from authorities. This is not surprising, considering that these institutions were undertaking deposit activity for the first time.

Maintaining a two-tiered interest rate structure was not always a simple process for most banks. High effective loan rates incorporated additional commissions, fees and even insurance policy premiums in some cases, reflecting the true cost of lending. Micro and small loan interest rates were generally higher than the commercial lending rates, as seen by comparing columns 3 and 5 in Table 3.6. This was necessary to cover the higher cost of microfinance lending, as will be discussed subsequently. This two-tiered interest rate structure, however, was reported by a number of banks to be looked upon unfavorably by the clients and the community. This created an ongoing tension and potential threat from political and regulatory authorities in these countries. Standard Bank in South Africa was always experiencing this threat from the inception of its microcredit program.

C. NGO Linkages

It is clear that micro loans offered through commercial banks share some similarities with micro loans offered by non-bank NGOs. Moreover, the loan screening and monitoring tools used by these bankers (described in Chapter Two) have more in common with NGO screening and borrower monitoring tools than with traditional commercial lending practices. In some cases, part of the human capital training benefited from visits to some of the successful microfinance operations around the world such as BancoSol in Bolivia and ADEMI in the Dominican Republic. Some differences, nonetheless, exist such as the predominant use of individual loan technologies, larger loan sizes, and longer term structures that characterize commercial bank micro loans. It is not surprising, therefore, to find that the majority of the commercial banks have either established their own microfinance units or have integrated microfinancial services in their own portfolios rather than choosing to partner with NGOs.

Only one bank, Banco Wiese in Peru, reported working directly through NGOs to disburse its micro loans. This bank allows the network of NGOs with which it operates to handle all the lending

[6] South Africa still maintains a usury interest law which prohibits banks from charging interest rates higher than ten percentage points above the prime rate.

processes. These downstream NGOs in Peru largely use a group lending methodology. The bank merely acts as a window for receiving loan repayments. Given the alleged extensive network of good NGOs in Peru, it was felt that NGOs had the expertise that would be difficult or costly for the bank staff to acquire. It is interesting to note that the bank leaves all the lending decisions to each of the 17 NGOs they work with while using its own deposit base to fund these micro loans. It is not surprising to note that the president of this family bank is behind this activity, which at present takes up about one tenth of the bank's total lending portfolio.

Another bank, Banco Agricola Comercial in El Salvador, has been successful in incorporating individual clients into its portfolio with a guarantee from NGOs in its lending areas. This represents an alternative way of incorporating NGOs into commercial bank microlending and appears particularly promising for NGOs familiar with individual loan technologies (and therefore individual clients).

A number of banks stated they would feel uncomfortable dealing with NGO intermediaries in their countries since they knew very little about them. Nevertheless, the existence of a well-functioning NGO community successfully servicing poor clienteles could clearly offer some banks a less expensive and less demanding avenue to service low income clienteles with loans than necessarily choosing to undertake this task themselves (McGuire and Conroy, 1997). However, banks face an information problem here. They have to somehow discover good NGO candidate-partners and avoid weak organizations. An NGO rating agency could possibly reduce these information costs and increase social benefits through an expansion of microfinance services to these clienteles. The public good feature of a rating agency could justify the use of donor subsidies to support the development of the information base which in the end could elicit more NGO-bank linkages.

D. Technical Assistance

Technical assistance has played a very significant role in setting up the microfinance units, in educating and training staff members in these units, in transferring the microfinance technology to the banks, and in monitoring the progress of their operations for a period of time (Table 3.3, column 3). Typically, donors cover the costs of the technical assistance experts brought in to support the organization while learning about microfinance. The National Bank for Development, Centenary Bank, Bank Rakyat Indonesia, Caja de Ahorro y Crédito Los Andes, Financiera Familiar, Banco Empresarial, Banco del Pacífico, Banco del Desarrollo and the Workers' Bank are among the institutions which have benefited from technical assistance for periods of time ranging from a few years to as long as 10 years. Visiting non-bank NGO operations that have been in the microfinance business for some time has also been undertaken to educate bank managers about this area of finance.

A number of organizations have experimented with different lending technologies such as group versus individual loans until they decided that individual loans were the most appropriate lending technology for their institutions. The technology transfer of microfinancial products, therefore, is not exactly duplicated from one setting to another. Technical assistance, in some cases, works with local bank managers to reach a viable bank-specific model for delivering microfinancial services. In other cases, a number of organizations, such as the Family Finance Building Society, Bank

Dangang Bali, Panabo Rural Bank, Scotia Enterprise, Banco Agrícola Comercial, and Multicredit Bank have established and managed their own microfinance units independently.

E. Human Resources

The case load or number of clients per loan officer was generally in the neighborhood of two to three hundred, although the range was from as few as 50 cases to as many as 1000 cases (Table 3.8 column 5). Programs with low case loads had just recently launched operations. The unusually high loads are associated with long-standing programs operating in very densely settled areas. These numbers could vary among loan officers within the same bank, as performance-based remuneration schemes were used by a number of banks particularly for their microfinance activities. While the majority of the banks, the National Bank for Development, Centenary Bank, Bank Rakyat Indonesia, Bank Dangang Bali, Caja de Ahorro y Crédito Los Andes, Scotia Enterprise, Financiera Familiar, Banco Empresarial, Multicredit Bank and Banco del Desarrollo, had staff incentive schemes, a few organizations that had a small number of credit officers did not feel it was necessary.

Monthly remuneration (plus maximum bonuses) ranged from \$100 for the National Bank for Development in Egypt to as high as \$1,300 for Financiera Familiar in Paraguay (Table 3.8, column 2). Most salary levels, reflecting diverse market conditions for bank-trained staff, fell between \$250 to \$800 per month. Whether individual or team-based, remuneration incentives in some cases allowed loan officers to almost double their base salaries, as can be seen in comparing column 2 to column 1. In a few cases, bankers reported that this was a source of tension for other bank employees who did not receive these bonus remunerations. Most banks stated this was not yet a problem since the microfinance staff salaries plus their maximum incentives did not yet exceed the salaries of other bank employees. In some other cases, such as the National Bank for Development, Bank Dangang Bali, and Banco Empresarial, all bank staff received comparable remuneration or bonuses; thus, the potential for intra-bank tension among the staff did not exist.

III. Microfinance Products and Technology

A. Loan sizes, Maturity, and Interest Rates

Micro loans are distinctly different from traditional bank loans. Commercial loans as well as consumer loans are typically secured loans offered at interest rates that are lower than those associated with micro loans. These differences are significant among the more conservative large commercial banks such as the National Bank for Development in Egypt, Standard Bank in South Africa, Nova Scotia Bank in Guyana, Financiera Familiar in Paraguay, Banco Pacífico in Ecuador, and Banco del Desarrollo in Chile. Typically, these institutions offer micro loans through a separate window or part of the branch office that handles only these products and not through a common bank branch window. This allows both staff and clients to recognize the differences between the terms and conditions of micro loans and commercial loans more clearly and reduces the confusion that might arise otherwise. The different microfinance culture, discussed earlier, also contributes to this arrangement.

Some banks, although offering micro loans distinct from commercial loans, nevertheless offer all their financial services at the same branches. This is the case for Family Finance Building Society in Kenya, Bank Dangang Bali in Indonesia, Panabo Rural Bank in the Philippines, Banco Empresarial in Guatemala, Multicredit Bank in Panama, and the Workers' Bank in Jamaica. Again, commercial loans at these organizations are collateralized and offered at interest rates lower than micro loan rates.

Micro loans are generally provided with terms and conditions different from those associated with the traditional loans provided by private commercial banks (see Tables 3.4, 3.5 and 3.6). Although these micro loans share some terms and conditions with the micro products provided by microlending NGOs, there are some significant differences. First, bank micro loans generally reported larger average and maximum size loans. Nevertheless, average loan sizes (based on volume of loans outstanding by number of active clients) among the 17 banks reviewed were lower than had been expected by the authors. Overall, they had an average loan size of less than $1,400. Two banks had average loan sizes under $300 and two banks at the upper end had loan sizes under $4,000. The breakdown among the 17 banks with microlending portfolios was as follows:

Bank average loan size under $300	:	2 banks
Bank average loan size $301 to $1,000	:	7 banks
Bank average loan size $1,001 to $2,000	:	4 banks
Bank average loan size $2001 to $3,000	:	2 banks
Bank average loan size $3,001 to $4,000	:	2 banks

Second, although commercial banks offer micro loans with a minimum maturity as short as one to a few months, still some allow the maximum term for these loans to extend as long as two to four years (Table 3.5, column 2).[7] As discussed earlier, examining the ratio of the number of loans disbursed to loans outstanding (Table 3.1, column 5) implies that the majority of these banks offer loans that typically extend for periods longer than one year.

Third, the pricing of micro loans is set to cover the cost of making these loans, typically yielding higher effective interest rates than commercial loan rates as well as some NGO loan rates (Table 3.6).[8] Effective interest rates reported by bankers from various regions of the world ranged from 30 to about 60 percent per annum (column 3, Table 3.6). Examining the real rates for both commercial and micro loans indicates positive and significantly higher rates for micro loans than for commercial

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[7] Some banks allow maximum maturity of up to one year, such as the National Bank for Development, Panabo Rural Bank, Banco Empresarial and the Workers' Bank, while a few others extend the loan maturity up to two years such as Centenary Bank, Scotia Enterprise, and Financiera Familiar. Some banks offer a maximum micro loan term for as long as three, four or even five years.

[8] Effective micro loan interest rates presented in Table 3.7 were reported by the bank representatives during individual interviews. Different definitions of effective rates might have been used.

rates. This suggests it is, therefore, a necessary but not a sufficient condition to have positive real interest rates in an economy to allow banks to charge even higher rates to cover the cost of their microfinance activities.

B. Repayment, Disbursement and Collateral

Among the similarities between commercial bank and NGO micro loans is the frequent repayment schedule that banks seem to have adopted for their micro loans (Table 3.5 column 4). Bi-weekly, weekly, and even daily repayments are associated with micro loans in a number of institutions in addition to the more traditional monthly repayments. This shorter time period facilitates monitoring and is usually calibrated to the cash flow in the business. At the other end of the loan process is the significantly shorter time spent in processing micro loans, ranging from one to seven days (column 3). This short disbursement time has been adopted by most organizations. The quick loan disbursement procedure is similar to the quick turnaround practiced by many microlending NGOs. It is noteworthy to mention that many organizations assume part of the transactions costs by going to their borrowers rather than requesting that their borrowers come to the branches, particularly during the loan processing period.

Interestingly, some micro loans are offered without tangible collateral such as with the Panabo Rural Bank market vendor clientele in the Philippines, Family Finance Building Society loans that are below the equivalent of US$100, and the micro loans at the National Bank for Development in Egypt. In general, uncollateralized micro loans are granted to clients who have been savers with their organizations for quite some time. Collateral foreclosure in case of default usually encounters lengthy and difficult legal procedures. Hence, many banks avoid foreclosure of collateral on defaulted loans.

In summary, the downscaling private banks have implemented micro client products, services, and procedures that have been commonly adopted by non-bank microlending NGOs such as high, cost-covering interest rates, flexible short term loans, frequent repayment schedules, minimal to no collateral, and quick disbursement practices. To some extent, key bank personnel likely adopted some of these products and procedures after having visited and evaluated the more successful NGO programs such as BancoSol in Bolivia or the successful micro lending division of Bank Rakyat Indonesia. On the other hand, a good many of these products and procedures are an inevitable consequence of trying to reach low income, low asset clienteles of the poor and near poor in developing countries.

C. Lending Technology

As micro loans represent a new product type for most commercial banks, new screening and monitoring tools have been adopted by these banks to evaluate and manage the risks involved. These tools are distinctly different from the collateralized small loans and consumer loan facilities that are offered simultaneously by some of the banks currently involved in microfinance. It is important to note, however, that with the exception of BancoSol, Scotia Enterprise and Banco Wiese, a substantial majority of commercial banks engaged in microfinance are offering individual loans rather than group loans (Table 3.3, column 5). The Banco Empresarial in Guatemala also has a small pilot group loan program for market vendors in addition to their individual loan products.

This individual micro loan technology largely characterizes downscaling organizations adding microloans as a new product line and stands in sharp contrast to the predominant group lending technology that characterizes many microlending NGOs in the world of microfinance. It should also be noted that this trend seems to have emerged as the principal type of lending for most commercial banks after some had experimented with group loans and largely abandoned them to concentrate on individual loan technologies. Among the reported difficulties with group loans were the costs of group formation, management, and high drop out rates. There are very few cases of any bank or non-bank NGO being able to manage both individual and group loans simultaneously on any large scale. Conceivably, BancoSol, a preeminent group loan microlending NGO that became a bank in 1992, may become the first institution to succeed at this task given its already strong and well-established group loan technology and the fact that it is now engaged in a determined drive to also incorporate more individual loans with staff recruited from the banking industry in Bolivia. It is still problematical whether an already established private commercial bank will ever move successfully into group loan products on a large scale.

D. Deposit Services

Data in Table 3.7 underscore the importance of deposit services for downscaling private banks. This stands out in contrast to the minor role of savings accounts in the one former NGO, non-bank institution, Caja de Ahorro y Crédito Los Andes in Bolivia (Table 3.7, column 1). However, it should be noted that Caja Los Andes has only recently begun to mobilize savings under its new charter which now allows it to capture deposits. The relatively large number of savings accounts below \$500 (Table 3.7, column 3) indicates that deposit services are also contributing substantially to the outreach performance of these institutions. Indeed, there are many more micro client depositors evident in column 3 of Table 3.7 than there are micro borrowers in column 1 of Table 3.1. It is of interest to note the rapid increase in savings accounts in BancoSol to almost 46,000 accounts. This is a creditable performance when one keeps in mind that up to 1992, BancoSol was a credit-only NGO with no deposit services.

Compulsory savings (Table 3.7, column 4) are enforced for clients with micro loans by only a few banks, namely the National Bank for Development in Egypt, Family Finance Building Society, Scotia Enterprise, and Banco del Desarrollo. These institutions require their borrowers to deposit a part of their loans in a savings account, ranging from 10 percent at the National Bank for Development in Egypt up to 30 percent for large loans at Scotia Enterprise in Guyana. Savings, in other cases, are used partially in the loan screening and monitoring process. While Family Finance Building Society in Kenya does require that all borrowers be savers for at least six months, other organizations such as the Bank Dangang Bali and Panabo Rural Bank in the Philippines do not require borrowers to save, but nevertheless independently encourage savings (Table 3.7, column 5). The Bank Dangang Bali, along with Banco Empresarial, Multicredit Bank, Standard Bank, and

Centenary Bank, have either individual savings incentives such as lotteries, very low minimum balance requirements, or overall rewards for bank managers for successful savings promotion. The Bank Dangang Bali, Panabo Rural Bank, and Family Finance Building Society, among others, reported that savings provide information about prospective borrowers which makes loan screening and monitoring procedures somewhat less difficult and more efficient.

E. Screening and Monitoring

Typical screening techniques of micro clienteles receiving individual loan services involve credit officers making personal reference checks about prospective borrowers with informed individuals in the communities, with suppliers in the markets, and with other informal as well as formal lenders in some cases. Inspecting the business premises and the borrower's residence are also important means of verifying information and marking permanent locations for the borrowers. Cash flow analysis of the business and expenditure flow documentation of the household establishes the parameters within which feasible loan repayments can be scheduled. These business and household analyses of cash flow are essential features of the lending technology since collateral is less important in screening these clienteles. In most cases, this screening process is done on an individual basis. Nevertheless, in the case of the Panabo Rural Bank in the Philippines, micro loans made to vendors in the market are screened in a batch processing format where the loan officer verifies information with market suppliers and other lenders for a whole list of borrowers at the same time. Loan repayments are also used as an indicator in screening for repeat borrowers. In cases such as Centenary Bank, Caja de Ahorro y Crédito Los Andes, and Financiera Familiar borrowers who have fully repaid two to three loans on time get access to an automatic line of credit thereby reducing lending costs substantially for this repeat borrower clientele.

Borrower monitoring techniques are largely aided by daily, weekly, bi-weekly or monthly repayment schedules generated by computerized loan tracking systems (see column 4 of Table 3.5). Most banks stated that an effective software computer technology is essential to track and monitor loan repayments once the micro loan program grows beyond a rudimentary scale of activity. Loan officers conduct follow ups through telephone calls and personal visits in case of even one-day delinquencies. These measures are taken very seriously since many micro loans are granted with little to no collateral. In those cases when physical collateral is required for small loans (rather than micro loans), such as with Centenary Bank, Family Finance Building Society, Bank Rakyat Indonesia, and Bank Dangang Bali, the latter three reported that these loans were rarely foreclosed in cases of delinquency because of lengthy and costly legal procedures. Centenary Bank, due to recently improved contract enforcement rules in Uganda, has been more successful in foreclosing on collateral and pursuing bad debtors.

Table 3.1 Selected Indicators of Micro Loan Numbers and Volumes by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Total No. ML Out.	Total Vol. ML Out.	Total No. ML Disb.	Total Vol. ML Disb. US$	No. of Disb./Out (Col3/1)	Vol. of Disb./Out (Col 4/2)
		(1)	(2)	(3)	(4)	(5)	(6)
AFRICA							
1. Egypt	NBD	20,852	13.5M	35,830	43.5M	1.72	3.45
2. Kenya	FFBS	6,000	1.4M	5,500	800,000	0.92	0.57
3. Uganda	CERUDEB	3,900	5.8M	4,593	8.4M	1.18	1.45
4. S. Africa	Standard	226	138,000	None	None	n.a.	n.a.
ASIA							
5. Indonesia	BRI	2.40M	1.60 B$	n.a.	n.a.	n.a.	n.a.
6. Indonesia	BDB	13,133	43.1M	10,934	35.2M	0.83	0.82
7. Philippines	Panabo	1,602	1.61M	1,474	1.4M	0.92	0.87
LATIN AMERICA							
8. Bolivia	BancoSol	57,745	30.2M	140,864	80.9M	2.44	2.68
9. Bolivia	Los Andes	17,854	8.62M	36,998	21.8M	3.08	2.53
10. Chile	Desarrollo	17,500	17.6M	n.a.	21M	n.a.	1.19
11. El Salvador	Agrícola	9,305	14.8M	3,741	9M	0.40	0.61
12. Guyana	Scotia	9,000	1.2M	4,836	935,647	0.54	0.78
13. Peru	Wiese	4,760	19M	3,818	15M	0.80	0.79
14. Paraguay	Finan. Fam.	4,658	4.5M	2,935	3.2M	0.63	0.71
15. Ecuador	Pacífico	4,000	4M	250	160,000	0.06	0.04
16. Panama	Multicredit	1,450	8.6M	n.a.	7M	n.a.	0.81
17. Guatemala	Empresarial	840	2M	788	n.a.	0.93	n.a.
18. Jamaica	Workers	177	3.3M	177	3.36M	1.00	1.03

Source: Information presented in this report is based on data reported by the respective banks before the Commercial Banks in Microfinance Conference, Washington, D.C., November 18-20, 1996, as well as from interviews conducted with all the bank representatives during the conference. Information for BancoSol in Bolivia comes from C. Gonzalez-Vega *et al.* "The Challenge of Growth for Microfinance Organizations: The Case of Banco Solidario in Bolivia" in Hartmut Schneider (Editor) Microfinace for the Poor? IFAD-OECD, Paris, 1997 (Data as of June, 1995).

Note a: Names of banks: (1) NBD is the National Bank for Development; (2) FFBS is the Family Finance Building Society; (3) CERUDEB is Centenary Bank; (4) Standard is Standard Bank; (5) BRI is Bank Rakyat Indonesia; (6) BDB is Bank Dangang Bali; (7) Panabo is Panabo Rural Bank; (8)BancoSol is Banco Solidario; (9) Los Andes is Caja Los Andes; (10) Desarrollo is Banco de Desarrollo;(11) Agricola is Banco Agricola Commercial; (12) Scotia is Scotia Enterprise (Subsidiary of Bank of Nova Scotia); (13) Wiese is Banco Wiese; (14) Finan. Fam. is Financiera Familiar;(15) Pacifico is Banco del Pacifico; (16) Multicredit is Multicredit Bank; (17) Empresarial is Banco Empresarial; (18) Workers is Workers' Bank.

Table 3.2 Operating Charter, Type of Bank, and Degree of Commitment to Microlending by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Type of Charter	Type of Bank	Degree of Commitment	Years ML Active	Use of Own Deposit Base (%)	% ML in Total Portfolio	% Females in Portfolio
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
AFRICA								
1. Egypt	NBD	Pvt. Comm. Bank	Many S. holders	Small	7	20	3.7	13
2. Kenya	FFBS	Non-Bank Bldg. Soc.	Few S. holders	Extensive	12	95	85	11
3. Uganda	CERUDEB	Pvt. Comm. Bank	Few S. holders	Extensive	3	90	83	29
4. S. Africa	Standard	Pvt. Comm. Bank	Many S. holders	Negligible	4	100	Negligible	85
ASIA								
5. Indonesia	BRI	State Bank	Few S. holders	Extensive	12	100	Majority	25
6. Indonesia	BDB	Pvt. Comm. Bank	Few S. holders	Extensive	26	83	49	Majority
7. Philippines	Panabo	Pvt. Rural Bank	Few S. holders	Modest	12	70	27	50
LATIN AMERICA								
8. Bolivia	BancoSol	Pvt. Comm. Bank	Few S. holders	Extensive	5(as NGO) 4(as Bank)	65	100	68
9. Bolivia	Los Andes	Pvt. Non-Bank	Few S. holders	Extensive	5(as NGO) 1(as Bank)	0	100	63
10.Chile	Desarrollo	Pvt. Comm. Bank	Many S. holders	Modest	6	60	Small	50
11. El Salvador	Agricola	Pvt. Comm. Bank	Many S. holders	Small	10	60	3.3	Majority
12. Guyana	Scotia	Intl. Finance Unit	Subsidiary	Extensive	3	100	9	80
13. Peru	Wiese	Pvt. Comm. Bank	Few S. holders	Modest	5	100	10	45
14. Paraguay	Finan. Fam.	Pvt. Non-Bank	Few S. holders	Extensive	2	50	20	50
15. Ecuador	Pacifico	Pvt. Comm. Bank	Many S. holders	Small	23	95	2	40
16. Panama	Multicredit	Pvt. Comm. Bank	Few S. holders	Small	5	100	10	35
17. Guatemala	Empresarial	Pvt. Comm. Bank	Few S. holders	Extensive	3	100	11	10
18. Jamaica	Workers	Pvt. Comm. Bank	Many S. holders	Small	2	na	4.5	na

Source: Information presented in this report is based on data reported by the respective banks before the Commercial Banks in Microfinance Conference, Washington, D.C., November 18-20, 1996, as well as from interviews conducted with all the bank representatives during the conference. BancoSol data from Gonzalez-Vega *et.al., op.cit.*

Note a: Names of banks: (1) NBD is the National Bank for Development; (2) FFBS is the Family Finance Building Society; (3) CERUDEB is Centenary Bank; (4) Standard is Standard Bank; (5) BRI is Bank Rakyat Indonesia; (6) BDB is Bank Dangang Bali; (7) Panabo is Panabo Rural Bank; (8) BancoSol is Banco Solidario; (9) Los Andes is Caja Los Andes; (10) Desarrollo is Banco de Desarrollo;(11) Agricola is Banco Agricola Commercial; (12) Scotia is Scotia Enterprise (Subsidiary of Bank of Nova Scotia); (13) Wiese is Banco Wiese; (14) Finan. Fam. is Financiera Familiar; (15) Pacifico is Banco del Pacifico;(16) Multicredit is Multicredit Bank; (17) Empresarial is Banco Empresarial; (18) Workers is Workers' Bank.

Table 3.3 Origin and Organization of Microlending Activity by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Origin	Organization	Technical Assistance	Technology	Operating Costs/Loans out. (%)
		(1)	(2)	(3)	(4)	(5)
AFRICA						
1. Egypt	NBD	Downscaling	Separate unit	Yes	Individual	n.a.
2. Kenya	FFBS	Original mission	Integrated	No	Individual	20
3. Uganda	CERUDEB	Downscaling	Integrated	Yes	Individual	40
4. S. Africa	Standard	Downscaling	Separate unit	No	Individual	n.a.
ASIA						
5. Indonesia	BRI	Downscaling	Separate unit	Yes	Individual	12
6. Indonesia	BDB	Original mission	Integrated	No	Individual	3
7. Philippines	Panabo	Original mission	Integrated	No	Individual	n.a.
LATIN AMERICA						
8. Bolivia	BancoSol	Original mission	Integrated	Yes	Group	27
9. Bolivia	Los Andes	Original mission	Integrated	Yes	Individual	23
10.Chile	Desarrollo	Downscaling	Separate unit	Yes	Individual	14
11.El Salvador	Agricola	Downscaling	Separate unit	No	Individual	2
12.Guyana	Scotia	Downscaling	Separate unit	No	Group	n.a.
13. Peru	Wiese	Downscaling	Via NGO	No	Predm. Group	n.a.
14. Paraguay	Finan. Fam.	Downscaling	Separate unit	Yes	Individual	12
15. Ecuador	Pacifico	Downscaling	Separate unit	Yes	Individual	High
16. Panama	Multicredit	Downscaling	Integrated	No	Individual	21
17. Guatemala	Empresarial	Downscaling	Integrated	Yes	Predm. Individual	85
18. Jamaica	Workers	Downscaling	Integrated	Yes	Individual	n.a.

Source: Information presented in this report is based on data reported by the respective banks before the Commercial Banks in Microfinance Conference, Washington, D.C., November 18-20, 1996, as well as from interviews conducted with all the bank representatives during the conference. BancoSol data from Gonzalez-Vega *et.al., op.cit.*

Note a: Names of banks: (1) NBD is the National Bank for Development; (2) FFBS is the Family Finance Building Society; (3) CERUDEB is Centenary Bank; (4) Standard is Standard Bank; (5) BRI is Bank Rakyat Indonesia; (6) BDB is Bank Dangang Bali; (7) Panabo is Panabo Rural Bank;(8)BancoSol is Banco Solidario; (9) Los Andes is Caja Los Andes; 10) Desarrollo is Banco de Desarrollo;(11) Agricola is Banco Agricola Commercial; (12) Scotia is Scotia Enterprise (Subsidiary of Bank of Nova Scotia); (13) Wiese is Banco Wiese; (14) Finan. Fam. is Financiera Familiar; (15) Pacifico is Banco del Pacifico; (16) Multicredit is Multicredit Bank; (17) Empresarial is Banco Empresarial; (18) Workers is Workers' Bank.

Table 3.4 Selected Indicators of Micro Loan Sizes by Banks Ranked by Number of Micro Loans Outstanding by Region, 1995-96.

Region/ Country	Banks[a]	Min. Size $	Max Size $	Reported Ave. Size $	Estimated Ave. ML Size ($) Disbursed	Estimated Ave. ML Size ($) Outstanding	Ave. Outstanding ML/ GDP per Capita
		(1)	(2)	(3)	(4)	(5)	(6)
AFRICA							
1. Egypt	NBD	70	3,000	588	1,186	599	0.83
3. Kenya	FFBS	100	900	446	145	233	0.93
3. Uganda	CERUDEB	100	5,000	1,200	1,828	1,487	7.80
4. S. Africa	Standard	500	1,300	1,300	n.a.	610	0.20
ASIA							
5. Indonesia	BRI	11	11,000	500	n.a.	666	0.76
6. Indonesia	BDB	500	25,000	3,320	3,219	3,282	3.73
7. Philippines	Panabo	200	2,000	1,000	949	1,004	1.06
LATIN AMERICA							
8. Bolivia	BancoSol	20	3,000	550	575	522	0.67
9. Bolivia	Los Andes	10	42,000	580	589	482	0.62
10. Chile	Desarrollo	800	6,385	1,200	n.a.	1,005	0.28
11. El Salvador	Agricola	60	23,000	n.a.	2,405	1,590	2.27
12. Guyana	Scotia	108	7,195	500	193	133	0.25
13. Peru	Wiese	1,000	10,000	6,857	3,929	3,991	1.89
14. Paraguay	Finan. Fam.	400	6,500	n.a.	1,090	966	0.61
15. Ecuador	Pacifico	1,000	30,000	1,000	640	1,000	0.78
16. Panama	Multicredit	200	50,000	n.a.	n.a.	593	0.23
17.Guatemala	Empresarial	2,000	10,000	n.a.	n.a.	2,380	1.98
18. Jamaica	Workers	142	3,428	n.a.	13,333	12,994	8.44

Source: Information presented in this report is based on data reported by the respective banks before the Commercial Banks in Microfinance Conference, Washington, D.C., November 18-20, 1996, as well as from interviews conducted with all the bank representatives during the conference. BancoSol data from Gonzalez-Vega *et.al., op.cit.*

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ML = microloan.

Table 3.5 Selected Indicators of Micro Loan Maturities, Disbursement Periods and Repayment Schedules by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Min. Term (months)	Max. Term (months)	Loan Disbursement (Days)	Repayment Schedule
		(1)	(2)	(3)	(4)
AFRICA					
1. Egypt	NBD	1	12	2-5	wk./month
2. Kenya	FFBS	6	36	Few	month.
3. Uganda	CERUDEB	3	18	6-7	wk./month
4. S. Africa	Standard	9	36	5-7	month
ASIA					
5. Indonesia	BRI	6	36	n.a.	month/seas.
6. Indonesia	BDB	1	36	1-3	daily/month
7. Philippines	Panabo	3	12	n.a.	wk./month/qrtr.
LATIN AMERICA					
8. Bolivia	BancoSol	1	36	3-7	weekly/bi-wk./monthly
9. Bolivia	Los Andes	1.5	24-48	3-4	bi-weekly
10. Chile	Desarrollo	1	36	2-5	month
11.El Salvador	Agricola	12	72	n.a.	monthly
12. Guyana	Scotia	4	24	3-7	bi-weekly
13. Peru	Wiese	1	60	n.a.	weekly
14. Paraguay	Finan. Fam.	12	24	1-2	wk./month
15. Ecuador	Pacifico	12	48	n.a.	month
16. Panama	Multicredit	4	36	8	bi-wk. /month
17. Guatemala	Empresarial	1	12	3	daily/month
18. Jamaica	Workers	3.5	10	n.a.	weekly

Source: Information presented in this report is based on data reported by the respective banks before the Commercial Banks in Microfinance Conference, Washington, D.C., November 18-20, 1996, as well as from interviews conducted with all the bank representatives during the conference. BancoSol data from Gonzalez-Vega *et al.., op. cit.*

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Table 3.6 Interest Rates and Selected Performance Indicators for Banks Engaged in Microenterprise Lending by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Reserve Req. (%)	Deposit Rate	ML Effective Rates	Real Effective ML Rate	Comm. Rates	Operating Costs/Loans Out.	Loan Loss/Portfolio Arrears (%)
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
AFRICA								
1. Egypt	NBD	25	11	30%p.a.	20.2	17	n.a.	5 (LL)
3. Kenya	FFBS	20	17	34%p.a.	20.6	32	20	2 (LL)
3. Uganda	CERUDEB	15	10	46%p.a.	36.6	46	40	10 (LL)
4. S. Africa	Standard		14	50%p.a.	39.4	17	n.a.	19 (LL)
ASIA								
5. Indonesia	BRI	3	17	32%p.a.	23.0	22	12	1 (LL)
6. Indonesia	BDB	3	17	30%p.a.	21.2	24	3	5 (LL)
7. Philippines	Panabo	9	9	40%p.a.	30.8	32	n.a.	2 (LL)
LATIN AMERICA								
8. Bolivia	BancoSol	10	7	48%p.a.	n.a.	N.A.	27	6 (LL)
9. Bolivia	Los Andes	10	7	3.5% p.m.	n.a.	N.A.	23	7 (LL)
10. Chile	Desarrollo	8	13	3.7% p.m.	n.a.	2 p.m.	14	4 (LL)
11.El Salvador	Agricola	35	14				2	5 (1 day)
12.Guyana	Scotia	20	12	25% p.a.	n.a.	N.A.	n.a.	1 (LL)
13. Peru	Wiese	10-15	15	41% p.a.	26.1	16 p.a.	n.a.	4.5 (LL)
14. Paraguay	Finan. Fam.	15	18	6% p.m.	n.a.	7.3 p.m.	12	6 (LL)
15.Ecuador	Pacifico	10	45	57% p.a.	27.2	48 p.a.	High	6.7 (30 days) 2 (LL)
16. Panama	Multicredit	10-15	7	32% p.a.	30.7	17 p.a.	21	6.5 (30 days) 6 (LL)
17.Guatemala	Empresarial	36	8	30% p.a.	16.8	23 p.a.	85	5 (30 days)
18. Jamaica	Workers	11	27	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Information presented in this report is based on data reported by the respective banks before the Commercial Banks in Microfinance Conference, Washington, D.C., November 18-20, 1996, as well as from interviews conducted with all the bank representatives during the conference. BancoSol data from Gonzalez-Vega *et al., op. cit.*

Note a: Names of banks: (1) NBD is the National Bank for Development; (2) FFBS is the Family Finance Building Society; (3) CERUDEB is Centenary Bank; (4) Standard is Standard Bank; (5) BRI is Bank Rakyat Indonesia; (6) BDB is Bank Dangang Bali; (7) Panabo is Panabo Rural Bank;(8) BancoSol in Banco Solidario b) N.A. means not applicable; n.a. means not available. (9) Los Andes is Caja Los Andes; 10) Desarrollo is Banco de Desarrollo;(11) Agricola is Banco Agricola Commercial; (12) Scotia is Scotia Enterprise (Subsidiary of Bank of Nova Scotia); (13) Wiese is Banco Wiese; (14) Finan. Fam. is Financiera Familiar; (15) Pacifico is Banco del Pacifico;(16) Multicredit is Multicredit Bank; (17 Empresarial is Banco Empresarial; (18) Workers is Workers' Bank.

Table 3.7 Selected Data on Deposit Activities for Banks Engaged in Micro Lending Activity by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Total No. of Sav. Accts.	Vol. of Sav. Accts. US $	No. of Sav. Accts. <500	Require Sav. For Loans	Special Sav. Incentives
		(1)	(2)	(3)	(4)	(5)
AFRICA						
1. Egypt	NBD	20,852	1.7M	14,031	Yes	n.a.
2. Kenya	FFBS	22,500	5.8M	18,000	Yes	Yes
3. Uganda	CERUDEB	60,900	9.3M	42,000	No	Yes
4. S. Africa	Standard	287,786	20M		No	E-plan
ASIA						
5. Indonesia	BRI	15.6M	2.8B$	majority	No	Yes
6. Indonesia	BDB	344,619	105M	315,934	No	Yes
7. Philippines	Panabo	10,019	34.6M	9,834	No	Yes
LATIN AMERICA						
8. Bolivia	BancoSol	45,911	n.a.	most accts.	No	No
9. Bolivia	Los Andes	360	1.2M	208	No	No
10. Chile	Desarrollo				Yes	No
11.El Salvador	Agricola	50,459	13.3M	38,169	No	Yes
12.Guyana	Scotia	2,700	N.A.	2,670	Yes	N.A.
13. Peru	Wiese	N.A.	N.A.	N.A.	N.A.	N.A.
14. Paraguay	Finan. Fam.	1,100	13.5M	400	No	No
15. Ecuador	Pacifico	8,000	n.a.	n.a.	No	No
16. Panama	Multicredit	1,750	145.3M	1200	No	Yes
17. Guatemala	Empresarial	20,000	33M	10,461	No	Yes
18. Jamaica	Workers	n.a.	51M	90,000	n.a.	n.a.

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Note a: Names of banks: (1) NBD is the National Bank for Development; (2) FFBS is the Family Finance Building Society; (3) CERUDEB is Centenary Bank; (4) Standard is Standard Bank; (5) BRI is Bank Rakyat Indonesia; (6) BDB is Bank Dangang Bali; (7) Panabo is Panabo Rural Bank; (8)BancoSol is Banco Solidario; b: N.A. = not applicable; n.a.=not available;(9) Los Andes is Caja Los Andes; (10) Desarrollo is Banco de Desarrollo;(11) Agricola is Banco Agricola Commercial; (12) Scotia is Scotia Enterprise (Subsidiary of Bank of Nova Scotia); (13) Wiese is Banco Wiese; (14) Finan. Fam. is Financiera Familiar; (15) Pacifico is Banco del Pacifico;(16) Multicredit is Multicredit Bank; (17 Empresarial is Banco Empresarial; (18) Workers is Workers' Bank.

Table 3.8 Human Resource Indicators for Banks Engaged in Micro Lending Activity by Banks Ranked by Number of Micro Loans Outstanding by Region 1995-96.

Region/ Country	Banks[a]	Base Salary per Month $	Salary plus Max. Incentive/month $	No. of Credit Officers	No. of other Employees	Case Load (Clients per Loan Officer)	ML Incentive System
		(1)	(2)	(3)	(4)	(5)	(6)
AFRICA							
1. Egypt	NBD	50	100	240	160	400	Both
3. Kenya	FFBS	535	N.A.	16	24	375	None
3. Uganda	CERUDEB	300	600	192	n.a.	123	Indvl.
4. S. Africa	Standard	652	N.A.	3	N.A.	250	None
ASIA							
5. Indonesia	BRI	275	350	50%	50%	450	Team
6. Indonesia	BDB	200	250	37	221	1000	Both
7. Philippines	Panabo	200	N.A.	1	N.A.	300	None
LATIN AMERICA							
8. Bolivia	BancoSol	345	345	183	119	402	None
9. Bolivia	Los Andes	400	800	54	n.a.	700	Indvl.
10. Chile	Desarrollo	400	560	84	37	325	Both
11.El Salvador	Agricola	457	N.A.	4		N.A.	None
12.Guyana	Scotia	250	250	3	2	350	Indvl.
13. Peru	Wiese	1,500	N.A.	11	N.A.	N.A.	None
14. Paraguay	Finan. Fam.	600	1,300	20	5	250	Indvl.
15. Ecuador	Pacifico	200-600	N.A.	80 Total	n.a.	250	None
16. Panama	Multicredit	450	600	21	21	90	Indvl.
17. Guatemala	Empresarial	100	N.A.	8	n.a.	50	Indvl.
18. Jamaica	Workers	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

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Note a: Names of banks: (1) NBD is the National Bank for Development; (2) FFBS is the Family Finance Building Society; (3) CERUDEB is Centenary Bank; (4) Standard is Standard Bank; (5) BRI is Bank Rakyat Indonesia; (6) BDB is Bank Dangang Bali; (7) Panabo is Panabo Rural Bank; (8) BancoSol is Banco Solidario;(9) Los Andes is Caja Los Andes; (10) Desarrollo is Banco de Desarrollo;(11) Agricola is Banco Agricola Commercial; (12) Scotia is Scotia Enterprise (Subsidiary of Bank of Nova Scotia); (13) Wiese is Banco Wiese; (14) Finan. Fam. is Financiera Familiar; (15) Pacifico is Banco del Pacifico; (16) Multicredit is Multicredit Bank (17) Empresarial is Banco Empresarial; (18) Workers is Workers' Bank.

CHAPTER FOUR: CONCLUSIONS AND RECOMMENDATIONS

I. Conclusions

The experiences of private commercial banks in microfinance are still relatively limited. Nonetheless, a few patterns are emerging and a number of challenges continue to require attention. First, the current outreach of commercial banks in microfinance is at best modest in scope. Some of the banks, such as Centenary Bank in Uganda, BancoSol in Bolivia, Scotia Enterprise in Guyana, and Banco del Desarrollo in Chile, have exhibited impressive growth rates in a short time.

Second, most commercial banks are largely using their own deposit base for micro loans. Donor funds and government rediscount lines still represent cheaper sources of funds for a number of organizations, but some conditions and limitations restrict unlimited use of these resources. Although all organizations started by cross-subsidizing microfinance units and activities for various periods of time, currently good repayment rates and high effective interest rates that far exceed the cost of funds allow most organizations to at least break even in the use of their own funds for microlending.

Third, commitment to microfinance among commercial banks appears to be more likely in small, specialized institutions with few shareholders, or in large institutions which have created an independent unit or subsidiary dedicated exclusively to microfinance. In both of these cases, financial products and technologies can be adapted to the microenterprise or low-income client. Based on the evidence, two other modalities, adding microfinance to small and medium enterprise officer portfolios or maintaining a microenterprise unit within an overall bank structure, did not appear to work as well.

Fourth, microfinance within commercial banks is largely attributed to the effort of a single or a small number of persons to promote these activities. Some of these individuals have been close to and aware of the NGO operations in microfinance. With few exceptions (*e.g.* Bank Dagang Bali, Financiera Familiar), microfinance in commercial banks has seldom been based strictly on profit-seeking motives.

Fifth, currently prudential regulation with two to three exceptions does not seem to discourage microfinance activities in most of these banks. No additional requirements, other than what is typically reported by commercial banks to the supervisory authorities, are requested of commercial banks because of their microfinance activities. The larger commercial banks are able to engage in sufficient self-provisioning to manage these activities properly. Most banks have the flexibility to price their products to break-even and cover their costs as well as make profits. Reporting, however, has been reported as burdensome in two cases among the smaller, more specialized banks. In addition one must note the special case of the two former microlending NGOs (BancoSol and Caja Los Andes), which transformed themselves into regulated financial institutions. These institutions had to adapt to a more rigorous reporting regime than previously. However, this represents a natural shift in regulatory standards as they moved from being credit-only NGOs to become deposit-taking institutions.

Sixth, commercial banks are offering micro loans that are different from their typical collateralized commercial and consumer loans. These micro loans, although sharing some similarities with NGO micro loan products, such as frequent repayments and quick and inexpensive disbursements are however, slightly larger in size and are granted for longer maturities than typical NGO loans. Moreover, micro loans provided by commercial banks are granted with different terms and conditions than traditional bank loans. This is evident from the fact that micro loans are offered by some commercial banks in separate locations from their traditional banking services, which helps bankers highlight the differences between their products. Higher interest rate charges and less rigorous collateral requirements stand out here for most banks.

Seventh, with the exception of BancoSol, Scotia Enterprise, and the Banco Wiese NGOs, commercial bank micro loans are largely provided on an individual basis rather than through a group lending technology. This individual lending trend stands in contrast to the group lending technology that many microlending NGOs have adopted.

Eighth, given that some important differences in operational practices exist between standard commercial bank and NGO micro loans, it was not surprising to find that bank-NGO linkages were not common among the sample. Only Banco Wiese follows that practice in Peru while another, Banco Agricola Comercial in El Salvador, draws upon NGO guarantees to lend to some individual clienteles.

Ninth, commercial banks benefited, in a number of cases, from donor-supported technical assistance that promoted the inception and identification of the appropriate lending technology in different settings. Technical assistance continues to provide guidance to a number of banks involved in microfinance, such as Centenary Bank in Uganda and Caja de Ahorro y Crédito Los Andes in Bolivia.

Tenth, recruitment of micro loan staff largely occurs from outside the bank. Furthermore, training new human resources is frequently undertaken with new staff recruited from local areas where bank branches offer microfinancial services. This allows credit officers close screening and monitoring of borrowers in their own environments, although in some African settings this practice has been altered to reduce the negative impact of strong kinship pressures on lending practices. Adequate remuneration of loan officers for their successful efforts, using performance-based bonuses dependent on the number and volume of loans and loan recovery record was also undertaken in the majority of banks issuing individual loans.

In closing, it is clear that donor resources and the technical assistance networks accessed through these resources can play an important catalytic role in launching these programs and breaking down fears or resistance in bank circles to these initiatives. Second, it is also clear that this role can be fairly short-lived, as the bank's own deposit resources are brought into play, and the bank's absorption of newly-recruited personnel and technological software packages give them the tools to carry on the promotion of these microlending programs as a commercial platform. Although scale and scope economies are limited in the beginning as separate units and new personnel and credit technologies are added, frequently with some donor support, a period of self sufficiency is generally reached after three to four years of experience.

II. Recommendations for the Donor Community

To conclude this discussion it is instructive to review the possible role for the donor community in encouraging successful bank initiatives in microfinance. The key obstacles for microfinance in commercial banks, outlined in Chapter Two, can serve as a useful framework within which to review donor opportunities.

A. Policy and Legal Environment

In general donors should act as a friend in court on behalf of the microfinance community in their dialogue with government authorities. This positive role has three components. First, donors should argue for the elimination of all repressive financial regulations such as interest rate ceilings and unusually burdensome reserve requirements or detailed directed credit schemes. Microfinance can and should be able to emerge and compete in open niche markets as long as formal lenders in financial markets are free to charge interest rates that cover their operating costs, risks and the opportunity cost of capital.

Second, donors should encourage policy reform creating a prudential regulatory framework that recognizes the idiosyncratic features of institutions engaged in providing microfinancial services.

Third, donors can play a role in arguing for more rigorous contract enforcement institutions in the countries in which microfinance initiatives are operating. While a number of microfinance institutions emphasize group loan products, many promote individual loans, especially the commercial bank community, and a few attempt to deal in both products. An effective contract enforcement environment is of vital importance to successfully issue and collect individual loans. The legal and juridical infrastructure is key here. Registry of liens is important as well as legal actions on postdated checks cashed with no back up funds. Given the modestly valued collateral typically used to secure individual microloans, excessive legal fees for court proceedings are inappropriate. Small claims courts in common law tradition could expedite contract enforcement proceedings in a cost-effective manner. Ex-ante collateral technologies must have a proper ex-post contract enforcement environment to operate effectively.

B. Commitment and Bank Culture

Access to outside funds at interest rates below market levels has been the most popular mechanism employed by donors in the past to encourage already functioning banks to experiment with microfinance programs. Normally, these have also been coupled with technical assistance of various degrees of intensity (from full-time resident advisors to training courses to observational trips). While cheap funds have helped encourage banks to enter the market, it is obvious that they *alone* are not enough to calm the fears of risk-averse bankers. Otherwise, there would be many more such programs. In most cases, commitment to microfinance among commercial bankers is more often explained by the vision of a strong leader within the bank. In other cases, commitment derives from an *a priori* understanding of the idiosyncracies of the target market, as in the case of the NGO transformations and the consumer and housing finance companies.

Donors are best advised to have a tool box of various offerings, such as pilot loan funds, funds for start-up expenses, technical assistance, information seminars on the microfinance market, trips to successful programs, a mix of which could be provided depending on the nature of the institution's commitment and needs.

Assuming interest extends beyond one or two banks in a particular country. an interesting alternative approach would be to offer funds to the highest bank bidder in an auction. Auctions could be held monthly beginning from an initial floor price which would change over time in relation to the trends in bidding transactions. This approach would be more transparent and introduce an element of market competition into the process of allocating resources for the market niches of microenterprise lending and take it out of the administrative control of a government or donor bureaucracy. The basic floor rate could initially reflect the interbank rate in the country in question with a portion of the total amount available put up for auction each month. In short, this approach is more consistent with the spirit of a market rather than an administrative allocation of resources directed to market niche lending.

C. Organizational Structure

The donor community is increasingly interested in discovering optimal tools for intervention to promote the expansion of financial services to the poor and near poor. More recently they have been exploring the avenue of APEX lending strategies where a second-level wholesale organization (the APEX) channels donor resources downstream through a network of independent retail institutions to service microenterprise borrowers. This strategy includes the possibility of working through commercial banks as well as retail level financial NGOs. Currently there are no rigorous studies establishing any proof that APEX strategies are the most cost effective strategy to reach low income clienteles with financial services. Arguments in favor of these strategies emphasize the alleged cost economies of channeling donor resources through wholesale units rather than attempting to reach downstream NGO organizations or banks directly. At the same time, allocation decisions to specific retail institutions would also be delegated to these APEX institutions. This strategy raises many questions that merit serious study that goes beyond the scope of this paper. Nevertheless, the authors feel that whenever APEX strategies are used to disburse funds to downstream banks or financial NGOs, donors should make sure that the APEX organization does not attempt to alter the organizational or operational norms of the retail institutions. The APEX should not introduce distinct terms and conditions such as interest rate ceilings, special impact assessment reporting requirements, or targeting criteria beyond the market niche itself. These interventions unnecessarily increase the transaction costs for downstream retail banks or microlending NGOs. These institutions should be free to set their own creditworthiness criteria and conduct their own evaluation of risk for their clienteles.

To the extent that donors may be concerned about the rigor of the credit technology currently employed by these retail institutions or programs, they should consider technical assistance to improve these lending practices not selective credit criteria introduced from an APEX. Moreover this technical assistance should be provided through an independent third-party organization, not the APEX. There is an inherent conflict of interests in having technical assistance come from the same institution supplying the funds for on-lending. Finally, the APEX should carefully document the comparative repayment record of downstream institutions employing its funds. In this way the APEX could generate positive externalities for the donor community by acting as a credit rating agency for its downstream institutional borrowers.

D. Financial Technologies, Human Capital Formation, and Productivity Enhancement

The areas of technology, human resources, and productivity can be logically joined from the point of view of the role of the donor community. Human capital formation and the knowledge of innovative credit technologies that generate improved productivity in the supply of microfinancial services have properties of a public good. The training and knowledge acquired by personnel in microfinancial institutions is disseminated widely as these trained employees move to other institutions and programs. Hence, social benefits are greater than private benefits as those institutions that did not invest in the training and knowledge generation nevertheless benefit from the spillover benefits from other institutions that did. In light of these positive economic externalities, subsidies may be legitimate.

Donors can contribute substantially to the growth of microenterprise lending programs through continued support for the widespread transfer of financial technology. This can be accomplished through promotion of a clearing house role for documentation of best practice organizations and sponsorship of visits and internships in best practice programs for candidates from newly established programs. Continued support is justified for proven NGO organizations or specialized consulting firms, skilled in disseminating best practice financial technologies to commercial banks and microlending NGOs. These organizations can contribute substantially to human capital formation and the potential for cost conscious productivity growth in new start-up programs. The costs of the technical assistance should be shared between the banks or microlending NGOs benefiting from this training and the donor community supporting these efforts. However, the share of the costs borne by the recipient bank or program should rise overtime to replace the donor share as user charges emerge as a market tested indicator of the success of incorporating best practice techniques.

E. Regulation and Supervision

Microenterprise units or programs should be expected to report regularly on the number, volume and loan recovery status of their outstanding portfolios. Therefore, reasonably sophisticated information systems and associated software technology are required to track and report on these portfolios once they move beyond a rudimentary experimental stage. The major regulatory issue centers on the degree of additional reserves and provisioning that would be appropriate for institutions handling microenterprise loans.

These regulatory issues manifest themselves differently in different institutional frameworks. Large private commercial banks with an established regulatory track record and a long history of operating from an ample deposit base are subject to much less risk than smaller and more specialized financial institutions, especially former microlending NGOs just launching their first deposit mobilization efforts. These larger banks typically make their own provisions for their microenterprise units. Since they have private owners with a strong interest in solvency and profits, one can assume that bank management will be watching the bottom line closely on their microlending programs given the opportunity cost of the bank's capital and deposits devoted to these programs. It would not appear necessary for regulatory authorities to introduce additional provisioning or detailed reporting requirements for the programs in these banks beyond the standard reports on the number, volume and provisioning the banks themselves undertake for these activities.

Former NGOs transformed into banks and smaller more specialized banks, in contrast, represent greater prudential risk. They have invariably been credit-only organizations and therefore are undertaking deposit taking for the first time when they purchase a bank franchise. Smaller and more specialized banks also represent greater risk, in this case, through the lack of a diversified portfolio dominated by a large share of small and microenterprise loans. Given the common risks of income shocks faced by their clientele groups, their interest earning revenue flows can experience greater volatility than those of a larger bank. To cover the risks inherent to these two types of institutions a higher capital adequacy standard should be considered than that used for the larger banks with microenterprise programs.

The role of the donor community in the regulatory realm is necessarily limited but still important. The essential role here should be to encourage and support dialogue between banks administering microfinance facilities and regulators. Periodic seminars and workshops could be continued along the lines of a recent dialogue between former financial service NGOs, relevant donor representatives, and regulatory authorities in Bolivia. This exercise produced useful guidelines for the NGO community considering the step of becoming banks (see Rock and Otero 1997). A comparable effort should be considered in selected African countries where both the NGO financial services community, on the one hand, and regulatory authorities, on the other hand, need to explore common issues and problems in a far more fruitful fashion. The element of distrust and lack of knowledge and experience in both constituencies cries out for a friend in court to help shape the agenda for a more sensitive and serviceable interaction between these two groups. The donor community could play an important role in undertaking this role.

In conclusion, two institutional challenges remain in the continuing evolution of these programs in microfinance. The first is the search for the most cost-effective organizational form for large banking institutions to incorporate microfinance in an organization inherently ill-suited to adapt to the cultural world of these clienteles. The second is the most appropriate governance structure for former financial service NGOs evolving into banks. In the former case integrated, separate or hybrid forms of organization are emerging through trial and error within different commercial banks in the developing world. In the latter case rapidly maturing microlending NGOs are experimenting with several forms of donor-sponsored capital share ownership arrangements in an attempt to find an acceptable substitute for conventional private owners. These novel ownership and governance structures are designed to maintain a commitment to the target group of microenterprise clienteles. For the institutions in this study these governance structures are still in an embryonic stage and have not stood the test of time. How these two institutional challenges work themselves out will play an instrumental role in shaping the future of microfinance in the commercial banking world.

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